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Politics this week

Jul 1st 2004
From The Economist print edition

Saddam charged

AP

Saddam Hussein, Iraq's former leader, was transferred to the “legal custody” of Iraq and brought before a special court to face charges of crimes against humanity. Arriving handcuffed and in chains, he refused to sign legal documents and called the proceedings “theatre”.

The American-led administration in **Iraq** under Paul Bremer formally handed over the reins of government to Iyad Allawi in a low-key ceremony on June 28th, two days earlier than expected; Mr Bremer, who had been America's proconsul since May 2003, flew out of Baghdad before John Negroponte had arrived as America's ambassador. The changed timing was meant partly to pre-empt possible efforts by insurgents to disrupt the handover.

See article

Amid renewed diplomacy over **Israel's** mooted withdrawal from the Gaza strip, violence surged. Israelis killed seven Palestinian fighters, including three leaders, in Nablus, the biggest town on the West Bank. A Palestinian rocket killed two Israelis in the Israeli town of Sderot, prompting the Israelis to reinvade part of the strip.

See article

The United States and **Libya** restored diplomatic relations after a break of 24 years.

Colin Powell, America's secretary of state, and Kofi Annan, the UN secretary-general, flew to **Sudan** to urge the government there to stop ethnic cleansing in the western region of Darfur.

See article

A semblance of justice

The American Supreme Court ruled that foreign terrorist suspects held at **Guantánamo Bay** had a right to challenge their detention in federal courts. The court also ruled that Yaser Esam Hamdi, an American citizen who allegedly fought for the Taliban, could challenge his detention. However, José Padilla, an American detained in connection with a “dirty bomb” plot, was told he must re-submit his appeal.

See article

The **Green Party** nominated David Cobb, a Texas lawyer, as its presidential candidate. The move came as a blow to Ralph Nader, who had sought the party's endorsement even though he is running as an independent candidate this year.

Michael Moore's controversial film, “**Fahrenheit 9/11**”, broke box-office records on its release in America. The film, which attacks George Bush's policies in Iraq, the war on terror and much else, earned almost $25m in its first weekend, the highest amount ever for a documentary.

See article

NATO training exercise

The **NATO summit** in Istanbul ended with a fragile agreement of all the alliance's members to train Iraqi soldiers. The alliance also pledged to increase its troop numbers in Afghanistan from 6,500 to between 8,500 and 10,000 in time for the election in September.

See article

George Bush also took the opportunity to urge the European Union to open membership talks with **Turkey**; France's Jacques Chirac retorted testily that this was none of America's business.

A special EU summit was convened to appoint José Manuel Durão Barroso, Portugal's prime minister, as the next **president of the European Commission**. Until all other candidates were blocked by differing countries, Mr Barroso had not even featured in the running.

See article

Boris Tadic, a pro-West liberal, won the **Serbian** presidential election. He defeated the extreme-nationalist candidate, Tomislav Nikolic, by a healthy margin, and vowed to push Serbia in a more pro-European direction.

Lord Ashdown, pro-consul of Bosnia, sacked 60 top officials in the **Bosnian Serb Republic** for failing to catch Radovan Karadzic, the Bosnian Serb leader who was indicted on war-crimes charges.

The **Czech** prime minister, Vladimir Spidla, resigned after his Social Democrats did badly in the European elections. An attempt will be made to construct a new coalition government, but an early general election is quite likely.

EPA

See article

Knock for six

The six-party talks bringing together the United States, China, Japan, Russia and the Koreas ended without a breakthrough. The next round of talks attempting to solve the crisis over **North Korea's** nuclear-weapons programme is set for September.

See article

The foreign secretaries of **Pakistan** and **India** met in Delhi for talks on Kashmir. The two countries agreed to reopen consulates in Karachi and Bombay and to restore their embassies to their full strength.

Pakistan's prime minister, Zafarrullah Khan Jamali, resigned after falling out with General Pervez Musharraf, the country's president. An ally of the general, Chaudhry Shujaat Hussain, was appointed as caretaker prime minister, amid accusations that Mr Musharraf was tightening his grip on the country.

See article

Almost a year after elections, **Cambodia's** two main political parties agreed to form a coalition. Hun Sen, the prime minister since 1985, remained in office.

In the minority

In **Canada's** general election, the Liberals remained the largest party, but lost their majority. The separatist Bloc Québécois did well. Paul Martin, the prime minister, said he hoped to form a “stable” minority government, rather than seeking a coalition.

See article

Haiti's former prime minister, Yvon Neptune, surrendered to police to face charges of organising the murder of opponents of the former president, Jean-Bertrand Aristide. Mr Neptune said the charges were politically motivated. Brazil, which has taken command of the UN peacekeeping force on the island, suggested a novel tactic for disarming Haitians: it may send its football team for a match at which each spectator would have to hand in a gun.

In the biggest demonstration in **Mexico's** capital in a decade, some 250,000 people protested against the ineffectiveness of the city and national governments in the face of a wave of violent crime, including kidnappings.

Lino Oviedo, a **Paraguayan** general convicted of an attempted coup and accused of murdering a vice-president, returned to his country after five years on the run. He was imprisoned.

AP

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Business this week

Jul 1st 2004
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Moving up

America's Federal Reserve raised **interest rates** by a quarter of a percentage point to 1.25%. The widely expected move, the first increase since May 2000, is likely to foreshadow a “measured” tightening of monetary policy.

See article

Oil prices fell close to a three-month low after the handover of power in Iraq eased some fears of further attacks on pipelines in the country. Iraqi exports resumed after supplies were disrupted by saboteurs. The Saudi oil minister described the current price as “fair”. Meanwhile, oil workers in Norway returned to work after a week-long strike.

Deadlocked talks aimed at lowering global **steel subsidies** were suspended until next year. Despite American pressure, many producers were unwilling to resolve differences over exemptions and special treatment for developing countries, and allow market forces to prevail.

Microsoft's voucher scheme

Microsoft settled class-action lawsuits in Massachusetts and Arizona that had accused the software giant of using its monopoly position to overcharge its customers. Microsoft will issue vouchers worth $105m in Arizona and $34m in Massachusetts.

Separately, a federal court turned down an appeal by Massachusetts and competitors to **Microsoft** against the software giant's 2001 settlement deal with the American government. The decision brought a six-year legal battle to an end.

Amazon responded to a lawsuit from **Toys “R” Us** with a countersuit demanding compensation of $750m and an end to their partnership, citing the toyseller's “chronic failure” to meet the terms of its contract. The giant toy retailer had previously alleged that Amazon, a leading online retailer, breached an agreement giving Toys “R” Us the exclusive right to sell toys and games through Amazon.

United Airlines suffered a further and final rejection of its bid to secure a federally guaranteed loan. Days after it was denied a $1.6 billion loan, the troubled airline had its request for $1.1 billion rebuffed. United will have to find money on the markets to help it emerge from Chapter 11 bankruptcy. A fundamental restructuring, including heavy job cuts, seems likely.

Final demand

A court upheld a demand from the Russian government that **Yukos** pay back taxes of $3.4 billion. The oil giant offered to pay around a third of what it owes—unpaid taxes, but no fines or penalties. Though previous attempts to strike a deal with the government have failed, President Vladimir Putin has denied that his aim was to bankrupt Yukos. The oil company also promised yet another appeal against the ruling.

Stuart Rose, recently drafted in by **Marks & Spencer** to fight a hostile bid and revive the British retailer's fortunes, became embroiled in a controversy because of his purchase of a tranche of shares in

M&S a short time before the bid was announced.

See article

Car trouble

South Korea's customary round of summer strikes began in earnest. **Hyundai Motor**, the country's biggest carmaker, suffered a two-day walk-out by 40,000 workers demanding better pay and conditions (and opposing the dispatch of South Korean troops to Iraq). Employees of Daewoo Motor also voted for a strike and industrial action affected Kia Motors.

Mitsubishi Motors, Japan's only unprofitable carmaker, received a fillip after investors agreed to boost a bail-out of the troubled firm by 17% to ¥546 billion ($5 billion). Mitsubishi has suffered from the recall of 800,000 vehicles this year and a cessation of financing by its partner, DaimlerChrysler.

Hanging up the phone

Nortel Networks announced that it would quit manufacturing telecoms equipment. The Canadian telecoms-equipment firm said it would sell some plants (for up to $525m) and contract manufacturing to Singapore's Flextronics. Nortel, which has recently suffered an accounting scandal, wants to concentrate on design, sales and marketing.

Virgin Mobile confirmed that it would launch its long-awaited initial public offering next month. Virgin Group will reportedly offer up to 40% of Britain's fifth-largest mobile-phone operator, in a float that is expected to value the company at some £1 billion ($1.8 billion).

On the eve of its merger with J.P. Morgan Chase, **Bank One** agreed to pay $50m to settle charges that it allowed the improper trading of mutual funds and also agreed to cut fees at its fund unit. Meanwhile, regulators began an investigation into the sales practices of **Capital Research and Management**, a large mutual-fund manager.

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Global security

Still taking on the world?

Jul 1st 2004
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His foreign critics need to notice that George Bush has now done what they want

SO NOW Iraq has a government of its own, “sovereign” if unelected, and endorsed by all the members of the UN Security Council. Saddam Hussein has been handed over to this government to be tried for his crimes, including the murder of perhaps a quarter of a million people. Here is the perfect moment, you might think, to begin to heal the rift that opened up at the beginning of 2003, when an alliance led by George Bush called on the world to support the invasion of Iraq, and an alliance led by Jacques Chirac of France said no.

So far it does not seem to be happening. If the world's leaders really wanted to make up, some of them had a golden opportunity to do so at this week's NATO summit in Istanbul (see article). Their achievements, to put it mildly, were modest. For example, all the alliance's members have an interest in making sure that Afghanistan holds successful elections in September and does not collapse again into a failed state. But all they agreed to do was to expand NATO's garrison in Afghanistan from an inadequate 6,500 troops to an inadequate 8,000 or so. Likewise, all the alliance's members have an interest in helping Iyad Allawi's new government calm Iraq ahead of that country's elections in January. But all that emerged on this front was an agreement to help train Iraq's security forces. And Mr Chirac says (though he has no veto) that even this has to be done outside the country. A NATO role in Iraq, he says, would have “tremendous negative consequences”.

Let's be friends—but not just yet

Mr Chirac might have a point, or at least half of one. It is not obvious that the Arab world would be pleased to see a western military alliance consisting of former imperialists and present occupiers—Europeans, Turks and Americans—exercise a more formal and visible role inside Iraq. On the other hand, the new Iraqi government needs, and has asked for, all the assistance it can get from competent military helpers. Moreover, Mr Chirac gives the troubling impression in such matters of being motivated not only by legitimate differences on policy but also by a personal animus against the American president. Even by his own brusque standards, the public scolding Mr Chirac gave Mr Bush for daring to say this week that it would be a good idea for Turkey one day to become a member of the European Union was amazingly rude.

What is worse, Mr Chirac is not alone. Most European leaders say in public that it is time to move beyond the quarrels over Iraq. But in private, much of Europe's political class detests Mr Bush and what he

stands for, which they think is throwing the superpower's weight around with no regard either for the rules of law, international treaties or the views of allies. Having noticed that Mr Bush is on the ropes at home—his approval ratings are down to 42%, his lowest score ever—they are longing for him to lose November's presidential election. Of course it is necessary to repair relations with the superpower, goes this calculation, but why not postpone the reconciliation till after November? That way, John Kerry can continue to pound Mr Bush for having needlessly alienated America's friends. And a President Kerry, it is widely if perhaps too blithely assumed, would pay a lot more heed than Mr Bush ever did to what the rest of the world has to say.

If this really is the calculation being made by some of America's so-called friends, they are playing a foolish game. For a start, it exaggerates both the go-it-alone instincts of Mr Bush and, in all likelihood, the practical difference a Kerry presidency would make in foreign policy. It is worth remembering that Mr Bush did in fact try quite hard to persuade the Security Council to authorise the Iraq war, and that Senator Kerry, for all his fabled fluency in French, favoured it too. He is not likely to change America's policy on either Kyoto or the International Criminal Court. As president, Mr Kerry might feel he had more leeway than Mr Bush to admit defeat in Iraq and rush for the exit. But he is hardly likely to believe that humiliation in Iraq can be good for America, and America is not defeated yet. So unless conditions there get very much worse, the probability is that a Kerry administration would stick to the plan it inherited from Mr Bush.

Scoring points, losing time

However, it is not just foolish of Mr Bush's critics abroad to withhold their full co-operation now in the hope of acquiring a more amenable partner later. Because of the present state of the world, it is dangerous, too. A world in this condition can ill afford the luxury of waiting another half-year for a new American president before pulling itself back together. The dangers of delay are most obvious in Iraq. Given that its election is supposed to take place in January, the battle to make a fair vote possible may have been won or lost well before American voters reward Mr Bush with a second term or turf him out of office. This means doing whatever is possible to bolster the resources and legitimacy of Mr Allawi's government right now, not some time later on. Meanwhile plenty of other problems cry out for decisive collective action by the big powers. Apart from the continuing threat of Islamic terrorism (where co-operation on intelligence does in fact seem to be improving) these include the horrific ethnic cleansing now under way in Sudan, the deadlock in Palestine, and the apparent attempts of Iran to build atomic weapons and of North Korea to keep those it says it has already built.

Time is not all that is at stake. Many people—including many Americans—look despairingly on the global disorder and conclude that this is the world Bush built. They say that he inherited an international system that was working well, but in a show of arrogance after September 11th went on to destroy it by pursuing a pointless vendetta against Iraq's dictator. It is a view that has the virtue of simplicity. But blaming too much on Mr Bush has a logical flaw. Well before the Iraq war, indeed before he was even elected, Sudan was at war, Palestine was in flames, and North Korea and Iran were flouting their obligations under the Nuclear Non-Proliferation Treaty.

What might be truer is that Mr Bush believed that America stood a better chance of solving some of these neglected problems by acting on its own than by letting itself be tied down by allies who cared only for a quiet life. If so, he should by now have learnt that this approach can be expensive, even if it has merits. The countries that opposed the Iraq war, led by France, were too weak to stop America. But they have shown that they have the power to damage its foreign policy simply by means of denunciation and abstention. The worry is that by continuing to denounce and abstain even after a chastened Mr Bush has complied with their wishes in Iraq, they will achieve the opposite of what they desire, by reinforcing the belief of many Americans that apart from a loyal few, such as the plucky Brits, most European allies are worthless.

Having an America which comes to believe that it can rely only on itself, and so cares only about itself, is in nobody's interest. Some might point to the ebbing of America's authority as a result of mistakes such as Guantánamo Bay (see article) and the torture scandal at Abu Ghraib and conclude that the last thing the world needs is American leadership. But the probable alternative is no leadership. Look around. Mr Bush is not the only leader in trouble. The leaders of most rich democracies are floundering. Mr Chirac is deeply unpopular. Germany's chancellor, Gerhard Schröder, has failed to make a success of economic reform and might not even limp through to his next election. Ditto, some say, for Tony Blair, whose support for Mr Bush has cost him dear. None of this makes for self-confident statesmanship. And while individual leaders flounder, no institution is well placed to fill the void. The European Union is fixated on

itself. The UN is divided and NATO is overstretched. It is past time to kiss and make up, even if, on the margin, his critics thereby help Mr Bush in November.

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The Supreme Court and Guantánamo Bay

Not good enough

Jul 1st 2004
From The Economist print edition

The courts are too slow. Congress must change the disgraceful treatment of detainees

ADMINISTERING justice to terrorist suspects is a complicated business. Few countries get it entirely right. It is hard, however, to think of any government that has got it wrong as counterproductively as the Bush administration has at Guantánamo Bay. Even allowing for the Supreme Court's intervention this week, it is time for America's friends and Congress in particular to do something about it.

The scope of the disaster is hard to exaggerate. The White House has managed to turn a generally reviled group of prisoners, most of whom were picked up fighting for al-Qaeda in Afghanistan, into figures of international sympathy. It has done this by denying these “enemy combatants” any semblance of western justice. Citing obscure judgments from the second world war and deliberately imprisoning the combatants in a military base it thought was beyond the reach of anyone's courts, it has sought to deny the detainees legal process of any kind, especially in the American courts, deprived them of independent legal advice and now intends to send them to military commissions, which offer the tantalising chance of appeal to a president who has already denounced them as bad men. The fact that John Walker Lindh, a white Californian caught in Afghanistan, was granted access to domestic courts has only added to the ghastly smell.

Guantánamo has presented an enormous propaganda coup to America's enemies—both directly and now indirectly through the horrors of Abu Ghraib prison. The military commissions have been denounced as unjust both by America's closest allies (including, this week, Britain) and by the soldier lawyers appointed to defend the first batch of detainees. Through his machinations, Donald Rumsfeld has created a legal Catch 22: the longer America keeps detainees in Guantánamo Bay, the less just it looks; but if it lets them go, no civilised court will convict them, because evidence produced under such conditions will be inadmissible.

This week, the American judicial system began the long task of righting this huge wrong. The Supreme Court said that Mr Bush had the right to hold combatants without trial but, crucially, it decided that the detainees at Guantánamo could have recourse to the United States courts—something Mr Bush has (disgracefully) fought hammer and tongs. It also ruled that Yaser Esam Hamdi, an American citizen caught in Afghanistan and held in a naval brig within the United States, could contest his classification as an “enemy combatant”, though it returned the case of José Padilla, another American citizen arrested in America, to the lower courts on a technicality.

It could be years before independent courts resolve the individual cases and it is unclear what right of recourse the detainees now have. However, by affirming that “a state of war is not a blank cheque for the president”, the court struck an important blow: the 595 detainees in Cuba and Mr Hamdi will now start their various appeals to the federal courts. The military commissions themselves may come under scrutiny.

So progress has been made. But it is plainly not fast enough, and it is also clumsy: the judges are making America's terrorist laws because the politicians have not done so. This is partly Mr Bush's fault. By taking the most vigorous view possible of the president's powers, relying on obscure lawsuits and choosing Guantánamo as their prison, his lawyers have managed to delay any proper attempt to review the cases in question. Even judged by Mr Rumsfeld's lengthening list of Pyrrhic victories, this one particularly hurts America's reputation.

However, the delay is also occurring because both sides are operating in a legal vacuum. Mr Bush's lawyers resorted to case law from the 1940s partly because no modern laws exist. Congress has spent billions of dollars on different forms of homeland security; but it has not passed any proper anti-terrorism laws of the sort that allow the authorities to hold suspects for longer terms and, yes, with fewer rights than other prisoners but still within the judicial system.

In his dissenting opinion on the Hamdi case, one of Mr Bush's favourite justices, Antonin Scalia, writes: “If civil rights are to be curtailed during wartime, it must be done openly and democratically.” For America's sake, Congress should act on that advice—and quickly.

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Sudan

Dousing the flames of Darfur

Jul 1st 2004
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Ethnic cleansing is leading to famine in Sudan. The world must act now to avert it

AT FIRST glance, the satellite photographs seem unremarkable: clusters of black circles on a map, as if a child had dipped a cup in black paint and stamped it repeatedly on a page. Then you realise that each circle is a hut that has been torched. The horrors of western Sudan are distant and under-reported, but no less real for that. To crush a revolt by black Africans in the Darfur region, the Sudanese government has armed the *janjaweed* , an Arab militia, and instructed it to kill, rape and terrorise civilians who, being black, are presumed to sympathise with the rebels. An estimated 1.2m people have been driven from their homes. Some have fled into Chad, but most are stuck in fetid camps within Darfur, where famine looms. The US Agency for International Development predicts that without help, 1m people may die, and that 300,000 will probably die whatever is done. That is the tragedy that Colin Powell, America's secretary of state, and Kofi Annan, the UN secretary-general, flew into Khartoum this week to avert.

Time is not on their side. Nor, despite its protestations, is the Sudanese government (see article). The regime in Khartoum admits that there is a humanitarian problem in Darfur, but says its scale has been exaggerated by malevolent foreigners. And it denies involvement in ethnic cleansing, though the refugees unanimously report that the militiamen who terrorise them are supported by government troops and bombers. The best thing about the regime is that it is weak. Its fear of American power has caused it to make concessions in the past, most notably in efforts to end a separate civil war in southern Sudan. A tough approach should yield results.

Messrs Powell and Annan sounded moderately tough this week, threatening UN action if Khartoum does not rein in the *janjaweed*, allow relief agencies unfettered access to Darfur and start serious negotiations with the rebel movements there. One must hope that, in private conversation with Sudan's president, Omar al-Bashir, they spoke even more forcefully. They have several levers. To jostle the government into making peace with the southern rebels, America has proffered carrots and sticks: aid if a formal peace deal is signed (as is expected soon), and sanctions if Khartoum fails to negotiate in good faith. These carrots and sticks should be made conditional on resolving the crisis in Darfur.

America should also threaten to establish a no-fly zone over Darfur, like the one that protected the Kurds from Saddam Hussein after the first Iraq war. If Sudanese planes continue to bomb civilians, they should be shot down. With luck, threats alone will be enough to bring Khartoum into line. But if they do not, America should be prepared to follow through.

The UN Security Council, meanwhile, should authorise all measures necessary to protect the vulnerable in Darfur. This would include the dispatch of peacekeepers to police the oft-broken ceasefire there, and to

make sure that food and other emergency supplies get through. The blue helmets will be needed even if the Sudanese government does everything asked of it. Though it created the *janjaweed*, it is far from certain that it can control it. *Janjaweed* commanders will not meekly lay down their arms, particularly since America has named seven as war-crimes suspects.

The rainy season is starting in Darfur, making it harder to move relief supplies overland. The world must act now. As Mr Powell noted, there will be plenty of time later to decide whether the atrocities in Darfur constitute genocide.

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Tiffany's lawsuit threatens eBay's eclectic market

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WHOEVER coined the old legal phrase *caveat emptor*, “let the buyer beware”, expressed an eternal truth. What was wise in pre-capitalist times remains wise in the internet age. Trading on the internet is becoming a part of everyday life. Millions of people go online to find goods, check prices and make transactions—usually without any problems. The internet has also dramatically lowered the cost of starting a new business or expanding an old one. But, inevitably, these enormous advantages are not confined to honest traders. Consumers have to be alert. Companies, too, have to protect their good names from fakers and other cheats. As Tiffany, a New York retailer famous for its expensive jewellery, has found, that is not always easy. But Tiffany's remedy, a lawsuit against eBay, the world's biggest online auctioneer, is a step too far. Co-operation among honest firms, rather than legal conflict, is the right way to combat internet dishonesty.

Tiffany's action against eBay concerns the sale of counterfeits. A recent search of eBay's American site found 610 necklaces, 707 rings and 668 bracelets sporting Tiffany's name. But with many items priced well below $50, most are clearly no more real than the $30 “Rolex” watches or $20 “Gucci” handbags offered in back-street markets everywhere. Nevertheless, Tiffany maintains that some people have been deceived. And it is certainly entitled to protect its name.

California-based eBay is expanding quickly abroad: after success in China it has just entered India. As both countries have been relatively relaxed about copyright and trademark laws, complaints like Tiffany's will probably increase. So far, eBay has successfully maintained that, as an electronic platform over which individuals come to trade, it cannot be held responsible for verifying the items being sold. It does not buy goods to sell on, like a retailer, nor does it organise individual sales or write the catalogue, as an offline auctioneer would. eBay's sellers write their own descriptions, set their own prices, establish their own terms, and collect the money from their own sales. They pay eBay a fee for its services.

eBay does have an obligation to prevent fraud, and an interest in doing so. It insists that all of its more than 100m users have to be registered and it makes their trading histories public. It also polices its websites and removes suspicious or illegal listings. And to help companies protect their brands it provides various services, such as the daily monitoring of specific auctions. It will also suspend repeat offenders.

Tiffany, however, says it tried these eBay services without success. Using two employees, over five

months it blocked some 19,000 listings. But still they came. Earlier this year, Tiffany purchased jewellery bearing its name from eBay and found that 73% were fakes. The basis of its lawsuit is that the amount of faked products is so substantial that eBay profits significantly from the trade, and promotes it, and so should “bear responsibility for the sale of counterfeit merchandise on its site”.

eBay vows to fight the case. It says it has helped Tiffany to remove problem listings promptly. Whether it has done enough is for the courts to decide. But eBay should not be held responsible for verifying the authenticity of Tiffany's, or any other company's, products. That would place such an onerous and impractical restriction on internet trade that it would deliver a severe blow to the popularity and efficiency of e-commerce. It would be like ordering newspapers to take responsibility for the authenticity of the goods and services which are offered for sale in their classified advertising.

In the end, it is the job of a brand's owner to defend its intellectual property rights, although that owner clearly deserves the active co-operation of any middleman whose services are being used to peddle fakes. Ultimately, the long-term success of eBay and other online traders will be built on trust, so they cannot afford to turn a blind eye to counterfeits. Meanwhile, as for centuries past, surfers would be wise to keep in mind that useful Latin phrase.

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European Commission

To Barroso the spoils

Jul 1st 2004
From The Economist print edition

The new president of the European Commission must be his own man

IT WAS hardly the most dignified way of making a big international appointment. On June 29th the 25 European Union heads of government unanimously chose José Manuel Durão Barroso, the prime minister of Portugal, to be the next president of the European Commission. But not only was he very obviously nobody's first choice; until a few weeks ago his name was not even on anybody's short list. Mr Barroso was given the job only after all the other candidates had fallen away in the face of objections from one side or another. In the eyes of his fellow prime ministers and presidents, in short, his chief asset is that he is little known and sufficiently low-key to have given no great offence to any of them.

Which makes it sound as if he will not be up to the job. That may be wrong. Although Brussels Eurocrats, depressed after the two ineffective commission presidencies of Jacques Santer and Romano Prodi, hanker after a man with the grand dreams and vaulting ambition of Jacques Delors, president in 1985-95, who pushed through the single market and plans for monetary union, a low-key but effective president may now be just what is needed. Mr Prodi is proud that the expansion of the EU to the east happened on his watch. But he was a poor communicator who sometimes failed to grasp every detail of his dossiers, so the commission played a smaller role in decision-making under his presidency. His successor should not be a visionary: he ought rather to be able to run a complex bureaucracy and take up the challenge of reconnecting the European project to ordinary people.

As it happens, Mr Barroso has qualifications that could help him in these tasks. Although his party is called Social Democratic, it is on the centre-right, which not only corresponds to the majority in the European Parliament but also puts Mr Barroso in the EU's pro-free-market camp. His country gave birth to the Lisbon agenda of 2000, an attempt to push forward the process of economic reform and liberalisation across Europe. He has made a decent fist of running Portugal over the past two years, including an honest effort to observe the budget-deficit ceilings set by the euro area's stability and growth pact. By hosting the Azores summit of government leaders from America, Britain and Spain just before the Iraq war, he identified himself firmly in the EU's Atlanticist, pro-American group. And although he professes ritual belief in European integration, he is no fervent federalist.

Indeed, Mr Barroso's arrival ought to please those who want the commission to play a limited, more effective and more liberal role. The British will like this more than the French and Germans. But the trouble is that Mr Barroso may already have paid a price to secure reluctant Franco-German endorsement. The rumour mill in Brussels has it that he will acquiesce in their plans to give the German commissioner the new post of supremo in charge of economic reform in the EU, and to put the French commissioner in charge of competition policy (see article).

Beholden to none

If he is wise, whatever understandings may have been cajoled out of him over agreeable dinners in Brussels, Mr Barroso will reject this plan. At a time when the broad goals for the EU are being set by national governments, the commission's key task is to police the system, which is a big challenge in an EU grown to embrace 25 countries. And who are the biggest offenders, the ones needing the most active policing? Why, France and Germany, whose leaders have most resisted economic reform and who have been openly touting “industrial policy”, the fostering of national champions, and more state aid and protection for their biggest companies.

Putting the fox in charge of the chicken coop can sometimes work in Brussels: a Frenchman, Pascal Lamy, has been a relatively liberal trade commissioner. But economic reform and competition policy are too crucial to the future of the EU for it to be safe to follow that example. Mr Barroso must resist the Franco-German stitch-up and insist on retaining for himself the last word, both over nominees to the commission and over the allocation of portfolios. If he fails to do that, his presidency will lack all credibility.

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British education

Few are chosen

Jul 1st 2004
From The Economist print edition

Anti-elitism dogs British thinking about education, and not just in the Labour Party

REMEMBER Tony Blair's three priorities when he came to power? Probably not, because, given the fervour and frequency with which it was repeated, Mr Blair's old mantra, “education, education, education”, has had surprisingly little impact. Seven years on, parents are still grumpy, the proportion spending up to £20,000 ($36,000) per child per year to buy their way out of the state system has increased and the government has yet to produce a coherent education policy.

Now parents are faced with a feast of such policies. This week it is the Tories; next week Labour. The central thrust of the government's widely-trailed plans is that the Academies, City Technology Colleges, Specialist schools and Beacon Schools adorning the government's education policy will be joined by a new category, Foundation Schools, and the number of Academies is to rise (see article).

Those more puzzled than excited by this announcement will not be alone. Beneath the profusion of names, the overall direction of change in education policy remains hard to discern. That's because there isn't much. Education is the last redoubt of socialist beliefs. Most of the party has accepted most of the modernisers' ideas. But deep in its heart Labour still believes that only by changing children do you change society, and that education's main purpose is to close the gap between the elite and the masses.

Don't mention selection

Forty years ago, the then Labour government started to dismantle a state system in which children were separated at 11 on the basis of ability, and began building a “comprehensive” system intended to heal social divisions. But by shutting down grammar schools this plan closed off the fast track for clever children and thus widened the gap between a state system in which equality took precedence over quality and an expensive and often excellent private sector.

Mr Blair knows all that, and wants to move away from it. That is evident not just in his vocabulary—“choice” and “diversity” are hot words in the New Labour lexicon—but also in some of the features of these schools with novelty names. Academies, for instance, have more independence than most schools and can select a few of their pupils. The trouble is that Mr Blair's instincts run counter to those of most of his party, which suspects, rightly, that “choice” depends on competition, that competition means that some do better than others, and that it thus threatens to recreate elite state schools.

As a result, although the government's policy is moving in the right direction, it is too timid. “Choice”, for

instance, doesn't mean much in education, because good schools swiftly get oversubscribed, and their head teachers have little incentive to take on more pupils or take over other schools. Paying successful head teachers more would encourage them, but it alarms those who believe that education is too fine to be tarnished by grubby financial incentives.

Similarly, the best way of getting schools to diversify would be to allow them to select. But that would undermine the egalitarianism that underpins old Labour beliefs. So specialist schools, supposedly at the cutting edge of the move towards diversity, are allowed to “give priority to” (“select” is a banned word) only 10% of pupils on the basis of their “aptitude” (“ability” is also forbidden) for sport, art, languages and IT—but not for most academic subjects.

So does the Conservative Party find it easier to reject anti-elitism? Only up to a point. After all, the education secretary who got rid of most grammar schools was Margaret Thatcher. Later, the Tories provided parents with more information about schools—by forcing them to publish results—but not with much power to change them.

The Tories' new ideas, published this week, show some improvement. They plan to let schools, rather than the state, determine selection policy. They also announced a sort-of voucher, under which the government would pay for children to go to private schools that charge no more than the average cost of educating a child in a state school (£5,500 a year). This, they say, will create lots of new low-priced private schools.

That the Tories are half way towards advocating educational vouchers (one of *The Economist*'s pet schemes) is a good thing. But there are two drawbacks. First, this proposal won't work: £5,500 won't cover the fees in most existing private schools, and innovators may hesitate to set up new ones knowing that the fees depend entirely on the government's whim. Second, it does not solve the main problem: that Britain is full of parents wanting to spend more on their children's education, but unable to afford private-school fees.

A fully-fledged voucher scheme, allowing parents to take state cash, top it up with their own and shop around, would be expensive, but it isn't just the costs that put the Tories off. Such a scheme would involve handing over state funds to posh private schools, and the Tories fear being accused of subsidising the elite. It is about time that they, like Labour, got over their hang-up about elitism. After all, there is one thing worse than having an elite: not having one.

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Letters

Jul 1st 2004
From Economist.com

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FAX: 020 7839 2968 E-MAIL: letters@economist.com

A woman's place?

SIR – I am stunned that a picture of the woman enjoying a hookah is captioned "Emancipation in Beirut" ("Out of the shadows, into the world", June 19th, print edition only). Smoking a hookah alone in public without a veil is not unusual in Lebanon, or indeed many other Arab countries. I am a Lebanese Arab man and a Sunni Muslim. Most women I know—married or not, veiled or not—have always worked and lived much as their western sisters.

Islam places some restrictions on women which deny them full equality with men, but many western societies have similar entrenched cultural restrictions. At least in Lebanon, women can choose whether to embark fully on an Islamic way of life. The condition of women in the Gulf states in general and Saudi Arabia in particular is abnormal and should be considered an exception among Muslim countries.

Rabih Bleik
Paris

Swapping sides

SIR – The Republicans' dominance of statewide elected offices in Pennsylvania is slightly overstated ("Pennsylvania's puzzles", June 12th). Barbara Hafer, the treasurer, switched to the Democratic Party in late 2003 after nearly 30 years with the Republicans. This is significant in itself, but also because Ms Hafer is nicely positioned as a pro-choice, western Pennsylvanian woman to make a run against the state's junior senator, Rick Santorum, in 2006.

Jeff Friedman
Philadelphia

Spain's rain drain

SIR – You claim that the new Spanish government came into power with "airy and potentially expensive promises" ("Zapping along", May 29th). As an example you say that the government scrapped the National Hydrology Plan (NHP), whereby water would be diverted from the north of Spain to the parched south, "without suggesting an alternative". This is false. The government's electoral programme clearly explains that the alternative is investment in the south in efficient irrigation, recycling of residual waters and desalination plants. The government's analysis shows that this would provide high-quality water both sooner and a lot more cheaply than the NHP.

Miguel Sebastián
Economic adviser to the prime minister
Madrid

Melodies bring memories

SIR – In your obituary of Ray Charles you say that Hoagy Carmichael wrote "Georgia On My Mind" (Obituary, June 19th). In fact, it was the lyrics to the song, written by my late father, Stuart Gorrell, which he sang so well and which made the song such a hit. My father was Carmichael's room-mate at Indiana University and afterwards in New York, where the song was written in 1930.

Mary Gay Gorrell Moore
Virginia Beach, Virginia

A snowball's chance in hell

SIR – The difficulty Brad Hays had melting a snowball in a microwave is because of the latent heat of ice (Letters, June 19th). This is used up in overcoming the forces holding the particles of ice together and is stored as energy in the water. It requires significantly more heat to melt ice than to heat the resulting water by, say, one degree Celsius.

Michael Metcalf
London

Virtuous cycle

SIR – In the eyes of *The Economist*, I am both suicidal and a zealot ("Chain reaction", June 19th). What marks me out in this way is not terrorist activity but participation in the annual cycle ride of British ministers, peers and MPs, as a representative of cycle users. I have enjoyed my cycling in London for more than 40 years without a scratch to show for it. Indeed, I have no doubt that my daily ride to work contributes to my good health, a belief that is supported by both scientific and government reports. Far from being an eccentric activity for the "steely-nerved", urban cycling is an enjoyable way of travel for a growing number of Londoners that improves the environment and helps to reduce traffic congestion. The example set by politicians who ride bikes merits praise not ridicule.

Tom Bogdanowicz
London Cycling Campaign
London

Write-offs written out

SIR – Unfortunately you seem misinformed about the development of corporate income-tax law in Germany since 1999 ("Talking telephone numbers", June 12th). Otherwise you would not conclude that in the public debate about the announcement of Vodafone's €20 billion ($21 billion) tax write-offs "the politicians have only themselves to blame". At least for the present coalition of Social Democrats and the Green Party this is wrong. The rules which allowed for such tax write-offs were substantially curtailed in 1999 and were completely abolished by our tax reform of 2000. In December 2003, we also restricted the rules on carrying forward losses—against fierce opposition from the Christian Democrats and Liberals.

Joachim Poss
Deputy chairman
Social Democratic Faction
Deutscher Bundestag
Berlin

Open and free

SIR – Was not the very first open-source movement the free market ("Beyond capitalism?", June 12th)? I am not surprised that *The Economist* applauds the broadening of the open-source movement. What surprises me is that you do not take more credit for it.

Bob Prentice
Toronto

At risk in Argentina

SIR – Your survey suggests that Argentina's failure to extend a higher offer to the bondholders "will be detrimental to its interests in the long run" (June 5th). Do you think that bondholders will rush back to lend if they receive a few more cents on the dollar? Néstor Kirchner must create conditions that will encourage the $100 billion pool of offshore savings to return home but he will not be eager to placate creditors unwilling to "stay in the game". Those who invested in Argentina and earned unbelievable returns clearly knew the risks they were running.

The Duhalde government botched many aspects of the economy. But it is easy to imagine a worse scenario with massive social disruption had the Duhalde and Kirchner governments not adopted the "populist" policies that rescued Argentina from the brink of disaster. The challenge now is for multilateral agencies to find a way to maintain the recovery and not fret about placating investors who clearly knew the risks.

Carlos Perez
Miami

Music everywhere

SIR – I appreciate your beaming over the iPod, but even the word "ubiquitous" fails to capture its hold on the New York subway ("The meaning of iPod", June 12th). If I see any more here it will be because people are carrying two or three apiece.

Cole Couture
New York

ONLINE ARTICLES

The following correspondence refers to articles published only online

Confused?

SIR – Your article (Buttonwood, Economist.com, June 22nd) states that "there seems to be no word in English for not being lost but not knowing precisely how to get somewhere". In America, we have such a word: "Democrat".

John Waldron

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The Philippines

Democracy as showbiz

Jul 1st 2004 | MANILA
From The Economist print edition

AP

Awash in money, celebrities and corruption, Philippine politics is fun to observe—but desperately in need of reform

Get article background

AT LAST, after a month-and-a-half of ballot-counting and bickering, the Philippines has a new president. Gloria Arroyo was sworn in for a second term on June 30th, and she has said that her top priority is to fix the country's rickety political system. Indeed, she has promised to set in motion a process of “charter change”, or *cha-cha*, as Filipinos call constitutional reform, within a week of taking office.

Those who doubt that the Philippine political system needs a dramatic overhaul should consider the case of Noel Cariño, a would-be representative from Pasig city, a suburb of Manila. Mr Cariño ran for a three-year term in Congress in 2001, but lost because of fraud. He challenged the result before the relevant congressional tribunal, but had to wait two-and-a-half years before it declared him the rightful winner. His rival, Henry Lanot, then appealed to the Supreme Court, which duly upheld Mr Cariño's victory and ordered him to be sworn in—on the last day of his term. Both men are now protesting against their defeats in their latest bids for office in the May elections.

The political structure of the Philippines mimics that of America, its former colonial ruler, with three co-equal and independent arms of government, a bicameral legislature and a strong executive presidency. But it has some unique features, including the way in which elections are conducted. Voters do not punch holes or tick boxes on ballots. Instead, they write the name of their preferred candidate on to the ballot by hand for each of dozens of different posts, depending on where they live and which offices are up for grabs. Poll workers must then spend as much as 15 minutes poring over each ballot, arguing about misspelled names and illegible handwriting.

Next, the returns from the polling stations are amalgamated manually, first at the municipal level, then in the various provinces, and finally nationwide. The whole cumbersome process in effect disenfranchises those voters who cannot remember the names of the people they want elected, or spell them correctly—quite a challenge even in much richer and more entrenched democracies. It also takes weeks to complete, and presents endless opportunities for fraud.

The temptation to commit fraud is all the greater because getting elected is ruinously expensive. There are more than 80m Filipinos, spread out over thousands of islands and around the world (7m-odd live overseas). They speak dozens of mutually unintelligible languages. Alex Magno, an adviser to Mrs Arroyo,

reckons it costs around 3 billion pesos ($53m) to mount a credible presidential campaign, in a country where half the population lives on less than $2 a day. Businessmen are reluctant to donate generously, since the government's power to regulate in their favour has diminished since the Philippines began liberalising its economy in the 1990s. So to recoup their expenses presidents must either resort to outright plunder, as Joseph Estrada, Mrs Arroyo's predecessor, has been accused of doing, or steal the ballot, as Mrs Arroyo's opponents say she did.

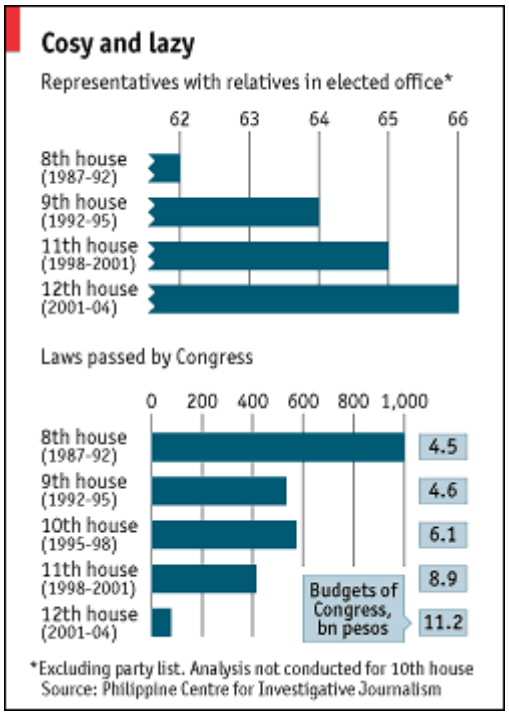
Family ties

Getting elected has become so expensive that celebrities, with their free name-recognition, are beginning to edge out the scions of the business elite who have controlled the Philippine legislature since the Malolos Congress of 1898. Mrs Arroyo's main rival for the presidency was a movie star; a televangelist also ran; two former news anchors competed for the vice-presidency, and the candidates for lesser jobs included comedians, sports stars and even a failed coup leader.

Logically enough, the older families have begun striking matrimonial alliances with these *arrivistes.* In 2002, for example, a fourth-generation legislator, Julio Ledesma, married Assunta di Rossi, a movie star. Robert Jaworski, the son of a famous basketball player, married into the family of Corazon Aquino, a former president. In the recent elections, he won Mr Cariño's former congressional seat in Pasig city.

Families, in effect, have superseded parties as the main form of political organisation. Over 60% of representatives in the outgoing Congress had relatives in elective office, according to an excellent new study from the Philippine Centre for Investigative Journalism (PCIJ)*. The proportion would be even higher if the 20% of seats reserved for marginalised communities were excluded. It has been rising slowly but steadily since the restoration of democracy in 1986 (see chart).

Congressmen spend their time in office consolidating these political dynasties by doling out jobs, favours and pork-barrel funds to their constituents. So they naturally gravitate to the camp of the leader who can provide the most largesse, often abandoning their party in the process. Presidents without a majority in the House of Representatives can build one overnight, provided they are willing to pay for it with hefty dollops of public money. Some families even keep members in all the major parties, to maximise their leverage. Thus the Dy family, which dominates the northern province of Isabela, has members in the camps both of Mr Estrada and of Mrs Arroyo, despite their bitter political rivalry. Sheila Coronel of the PCIJ cites the story of Ramon Durano, the head of a political clan from Cebu, who delighted in observing that all 12 of Jesus's apostles were his cousins, save Judas, who betrayed him.



Since political clans have few goals beyond preserving and expanding their influence, they have little interest in policy-making. In fact, they keep shedding their workload even as they raise their own pay. According to the PCIJ's figures, although the congressional budget has more than doubled over the past 15 years, the number of laws passed has shrivelled to 76 in the last Congress (see chart).

The Senate is the worst offender. Like the president and vice-president, the 24 senators are elected from a single, nationwide constituency. Having proved their broad appeal, they all consider themselves potential presidents. So they use their time in office to generate the maximum publicity. Needless to say, it is far easier to attract attention with noisy public hearings and dogged filibusters than through workaday legislative compromise.

The most spectacular political theatre comes in the form of impeachments. In 2000 Congress impeached the president of the day, Joseph Estrada, although it could not muster the votes to convict him. The next Congress tried to impeach the chief justice of the Supreme Court, twice. The court, for its part, is constantly meddling with the other branches of government: in the last elections, for example, it ruled on how the vote should be counted, how it should be monitored, who could run, where people should vote, how the results should be promulgated and so on—even though all these decisions are supposedly up to an independent commission. The constitution encourages the Supreme Court to meddle, by assigning it

the duty to scrutinise all acts of the government “to determine whether or not there has been a grave abuse of discretion”.

Filipinos, adopting an American turn of phrase, refer to the mutual interference among the different branches of government as a system of checks and balances. The 1987 constitution, which was drafted just after the overthrow of the 20-year dictatorship of Ferdinand Marcos, includes checks and balances galore to prevent a return to strongman rule. In practice, however, it actually promotes power-grabs by leaving the government in a near-constant state of gridlock.

Marcos himself was toppled by popular protests, as was Mr Estrada in 2001 after the failed conviction. When Mrs Arroyo, who was vice-president at the time, took over from him, rioters promptly attempted to displace her. Last year the army put down an attempted coup, as it has many times since Marcos's fall.

Throughout all this political paralysis and instability, the Philippine economy has limped along, hobbled by shabby infrastructure, low investment and massive public debt. Over the past 30 years it has grown by an annual average of 3.5%, compared with 5.8% in Malaysia and 6.5% in Indonesia. Worse still, population growth currently stands at around 2%, so the standard of living is hardly rising at all.

Efforts to clean up the country's finances tend to get lost in the congressional wash. The government's revenue is a modest 15% of GDP, but business lobbyists have stymied even unobjectionable money-raising schemes, such as indexing taxes on cigarettes and alcohol to inflation. The many lawyers in Congress recently decided to exempt their profession from value-added tax. The corrupt apparatchiks of the Bureau of Internal Revenue stopped collecting taxes to protest against a boss who had tried to stop them taking bribes, yet legislation to overhaul the agency is gathering dust in Congress. On the whole, the Philippines' ruling elite shows little interest in levying taxes they themselves might have to pay, or providing public services they themselves are unlikely to use.

The promise of parliaments

Mrs Arroyo's proposals for *cha-cha* are vague, but she insists on one point: that the Philippines should have a parliament and prime minister instead of a president and Congress. This is widely seen as a magic cure for instability. In a parliament there is less strife between the executive and the legislature, because the cabinet and prime minister are members of the legislature themselves. The government must enjoy the support of the majority, or at least a plurality, of members of the legislature, and should share a similar agenda.

Parliament and government also depend on one another for survival, since a prime minister usually has the power to call elections at will, while parliament can sack a prime minister at any time. In a presidential system, on the other hand, both Congress and the executive serve for fixed terms and cannot get rid of one another. They both also have popular mandates, and so feel justified in defying each other. The result: gridlock and instability.

AFP

Gloria has cha-cha in mind

Florencio Abad, a member of the outgoing House, points out that most durable democracies, especially in poorer countries, are governed by parliaments. Of the countries that became independent between 1945 and 1979, 41 adopted parliamentary systems, while 39 opted for strong presidents. Fifteen of the countries with parliaments remained democratic throughout the 1980s, while none of those run by presidents did.

But parliaments, especially in countries with weak party affiliations, are prone to instability of a different sort: wobbly coalitions, constant defections to and from the government ranks, hung parliaments, frequent elections and even more frequent changes of government. Nor is parliamentary rule alone sufficient to guard against military coups or street protests: think of Thailand.

Moreover, Mr Abad doubts that Filipinos would accept a system under which members of parliament, rather than the voters themselves, choose the country's paramount leader. Politics in the Philippines, he argues, is highly personalised, and voters view their power to pick the president as the most effective check on their often unresponsive and ineffectual government. Many analysts think that Filipinos keep electing celebrities because they dislike professional politicians and consider almost any outsider more

trustworthy. So a parliament, by strengthening the hand of political insiders, would fly in the face of Filipinos' political preferences.

Indeed, several of the most ardent advocates of a parliamentary system are politicians who have tried and failed to get themselves elected president under the current constitution, including Messrs de Venecia and Cojuangco. They are not the only self-serving proponents of charter change: Filipinos suspected Fidel Ramos, a former president, of plotting to amend the clause that limits presidents to a single term (except when they have served out part of their predecessor's term, as Mrs Arroyo did). Mr Estrada, for his part, was thought to be crafting amendments to favour crony businessmen.

In general, dramatic constitutional change risks confusing voters and further alienating them from politics. It may also have unintended consequences. Take, for example, the term limits written into the 1987 constitution for almost all elected positions. Advocates of the measure were hoping to put an end to political dynasties. But they ended up strengthening them, encouraging dynasts to recruit their wives or children to take their place when their allotted time was up. Only 30% of the first batch of representatives forced out by term limits were replaced by politicians with no clan affiliation, while the number of representatives with relatives in elected office actually rose. Several representatives who had served their maximum stint simply deputed their wives to keep their seats warm for a term, before returning to the House at the next election.

Congress is likely to frustrate future attempts at constitutional reform as well. The 24 senators, of course, will not want to abolish their own jobs, or the presidency, which they all covet. Over the years, many bills invoking constitutional conventions have stalled in both the House and the Senate. Gilberto Teodoro, a representative from the Nationalist People's Coalition, the most cohesive party in Congress, says simply, “I'll believe it when I see it.”

The public, too, is sceptical. A survey by the Institute for Political and Electoral Reform, a local think-tank, found that 69% disliked the idea of charter change, irrespective of what the specific proposals might be. All previous attempts to amend the 1987 constitution have failed, thanks to strong resistance from the public, NGO activists, respected politicians such as Mrs Aquino and the Catholic church, to which the overwhelming majority of Filipinos belong. Cardinal Sin, an influential former archbishop of Manila, even denounced the idea as sinful.

Reforms that may work

Luckily, there are some ways to improve the Philippine political system without resorting to charter change. To end the gridlock in Congress, for example, more disciplined and ideological parties are needed. A law prohibiting congressmen from switching parties mid-term would be a good start. So, too, would public financing for parties—something the outgoing Congress contemplated, but failed to enact. If all seats could be competed for by all parties (at present, some are restricted), this might encourage parties to try harder to develop proper platforms. It would also improve party discipline, by strengthening the hand of leaders over the uppity dynasts in their ranks.

A more radical step would be the abolition of the most egregious form of congressional pork: an automatic annual appropriation of 65m pesos for each representative, and 200m pesos for each senator, to spend on development projects of their choice. On the one hand, that would reduce the leverage of the president, who controls the disbursement of such funds. On the other, it would mean that congressmen would have to find different ways of pleasing their constituents. Some congressmen already reckon they get better publicity by loudly renouncing their allocation than they would by spending it.

Reuters

More care required, and less colour

Above all, Mrs Arroyo could push for a better electoral system. Before the last election, Congress appropriated money to automate the count, only to see the Supreme Court throw out the contract in question because of irregularities in the bidding. In fact, the Commission on Elections managed to waste billions of pesos on half-implemented schemes, including a national database of voters and an electronically transmitted “quick count” of results to complement the painstakingly slow official paper-trail. The head of the commission found his job so onerous that he collapsed on the eve of the vote, and again during the count.

A faster, less fraudulent count would result in fewer crooks getting elected. A simpler ballot would allow more people to vote, and so produce more representative results. In particular, making it easier for Filipinos living abroad to vote might add as many as 7m voters to the rolls, almost a quarter of the current electorate. Expatriate Filipinos, just because they are away from home, are less easily manipulated than their compatriots who have stayed.

Such niggling reforms, of course, are not the stuff of constitutional lawyers' dreams. But Filipinos are rightly wary of quick and grandiose fixes. And the sorry political culture of their country is, in fact, the sum of such details. Changing them would be an important first step—and a much easier one to take than wholesale constitutional reform.

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* "The Rulemakers: How the Wealthy and Well-Born Dominate Congress", by Sheila Coronel, Yvonne Chua, Luz Rimban and Booma Cruz. Philippine Centre for Investigative Journalism, Manila 2004

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The Supreme Court and enemy combatants

Too far, say the justices

Jul 1st 2004 | WASHINGTON, DC
From The Economist print edition

Rex Features

“A state of war is not a blank cheque for the president when it comes to the rights of the nation's citizens.”

Get article background

AFTER al-Qaeda's attacks of September 11th 2001, the Bush administration moved to claim extraordinary executive powers in the war against terror. In the words of a memo from the Justice Department's office of legal council, the president “enjoys complete discretion in the exercise of his commander-in-chief authority”.

Congress said barely a word, or passed a law to rein in this claimed authority. The press and public opinion have done a little more (the outcry that followed the publication of the 2002 “torture memo” persuaded the administration to disavow it). But this week, the final check on politicians' claims, the Supreme Court, ensured the administration's assertions would not go unchallenged. The court did not prohibit changes in the balance between individual liberty and security. But it insisted that it—not just the administration —would say how big the changes could be.

At issue were three cases all involving “enemy combatants”. As part of its claimed powers, the administration argued that captives from the Afghanistan conflict in 2001 were neither prisoners of war subject to the Geneva Conventions nor ordinary criminals subject to American courts. They comprised a new category. “Enemy combatants”, the administration said, could be held indefinitely, with either no or little judicial review. Foreigners were put in Guantánamo Bay in Cuba; Americans in domestic jails.

One of those was Yaser Esam Hamdi, a Saudi citizen born in Louisiana, who came into American custody after he was captured by Afghanistan's Northern Alliance. His father claims he was an aid worker. The administration says he was a Taliban fighter, and, on the strength of a two-page affidavit, has held him in isolation for almost three years, most recently on a military brig in South Carolina. This week, the Supreme Court said that treatment was unconstitutional because it did not give Mr Hamdi due process of law. The majority was eight to one, transcending the court's usual partisan split.

The ruling does not mean Mr Hamdi will be freed. It merely gives him the ability to contest his detention in court and the right to know why he has been labelled an “enemy combatant”. The justices disagreed on what they thought was the proper resolution in his case. The liberal John Paul Stevens and conservative Antonin Scalia united to say he should either be tried for treason or released. Two justices said he should not have been arrested in the first place. Four said the administration did have the right to detain him, but not indefinitely and not without review.

But what are the terms of that review and what is the standard of evidence? The four judges in the plurality said there would not necessarily have to be a fully-fledged criminal trial. They suggested some of the usual rules of evidence might be relaxed, but not be vitiated. In the cases both of Mr Hamdi and of another American detainee, José Padilla, the so-called “dirty bomber”, whose suit the justices this week refused to hear on a technicality, the lower courts had ruled that they could be held on “some evidence”. Justice Sandra Day O'Connor rejected that standard as inadequate.

That will encourage Mr Hamdi's lawyers when they go back to court. The original district court had wanted more evidence than the government's affidavit, but was overruled by a circuit court. Now the circuit court has been overruled, says Neal Sonnett, the head of the American Bar Association's task force on the treatment of enemy combatants, the government's lawyers will have to come up with more evidence to justify Mr Hamdi's continued detention—or go to trial. Either way, he says, “the administration may have to change its whole approach.”

That same conclusion applies to the court's third decision, governing the treatment of foreigners in Guantánamo Bay. In this case, brought by two Australians and 12 Kuwaitis, the Supreme Court also held that prisoners must have their day in court. It did so by granting them one of the oldest rights in the book, a writ of *habeas corpus*, which is a way of challenging imprisonment by requiring an explanation of why someone is being held. The administration, supported by a lower court, had argued prisoners did not have that right because they were foreigners and because Guantánamo Bay was beyond the reach of American courts. By six to three, the justices rejected both arguments.

That raises some awkward questions. Detainees can challenge their imprisonment in federal courts. But does any foreigner held by American authorities have that right, including Khalid Sheikh Mohammed or potentially Osama bin Laden, if he were captured alive? Dissenting, Justice Scalia implied that they might because “the court boldly extends the scope of the *habeas corpus* statute to the four corners of the earth”.

What sort of legal proceeding is appropriate? To judge by some of the justices' opinions, the court may be trying to nudge the administration into some sort of Geneva Convention-like judicial process, perhaps allowing trials using lower standards of proof (“preponderance of evidence” not “beyond reasonable doubt”). But a day after the highest court's ruling, military authorities charged three prisoners under the rules of military tribunals—a coincidence, insists the Pentagon.

Those questions will be addressed in future litigation. For the moment, Harold Koh, the dean of Yale law school, thinks the big effect of the decisions will be to constrain executive power and force the administration to submit to some (albeit unclear) level of judicial oversight. And he also tentatively suggests the decisions may be early signs of a changing attitude towards international law.

The court's rulings on prisoners were rooted in American precedent and legal practices. But, argues Mr Koh, they interpret the constitution in the light of international, not just American, norms. As Justice Stevens argued in his dissent in Padilla, “at stake in this case is nothing less than the essence of a free society.” Justice Scalia's concern about universal *habeas corpus* suggests he thinks international norms are influencing the court—to its detriment. In the two prisoner cases, the “internationalists” outnumbered the “nationalists”.

These were not the only examples. The day after the court's rulings, the justices held, by six to three, that victims of human-rights abuses anywhere in the world could sue their abusers in American courts. The justices did not provide victims with a carte blanche of course; Justice Souter said the law in question, the Alien Tort Statute, must be applied with “judicial caution”. But he rejected the administration's attempt to narrow the scope of the law and said the application of the statute, which was passed in 1789, should be guided by international norms with “definite content and acceptance among civilised nations”.

Fourteen of the cases before the Supreme Court this term and next concern America's relations with the rest of world. Those cases, along with the ones decided this week, should go some way to determining how far the Supreme Court justices agree with their predecessors who, in 1900, held bluntly that “international law is part of our law”.

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Latinos and the election

Every four years, the Anglos return

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Both parties need them. But what has either done for Latinos lately?

“SI, SE puede. Yes, it can be done.” If America's 40m Latinos dislike being patronised by Anglo politicians who throw a few words of Spanish into their standard platitudes, their leaders did not show it during John Kerry's speech in Phoenix to the National Council of La Raza (NCLR). The nation's biggest Latino organisation cheered.

The campaign wisdom is that, in an agonisingly close election, the Latino vote will be the difference between victory and defeat. Even Democrats admit that George Bush has the kind of personal “comfort level” with Latinos that Bill Clinton so famously enjoyed with blacks. In the 2000 election, Mr Bush's 35% share of the Latino vote was the highest for a Republican candidate since the 37% won by Ronald Reagan in his 1984 re-election. This time round the president's campaign-managers dream, not implausibly, of 40%. As Bill Richardson, the governor of New Mexico (and bilingual son of a Mexican mother), recently admitted, “the problem with Democrats is that sometimes they take our people for granted.”

Mr Richardson's warning is timely. Although Latinos have traditionally voted 2:1 for Democrats, they share plenty of the values preached by the Republican Party: self-reliance, the family, religious belief, the work ethic and opposition to abortion. Moreover, according to a Zogby poll commissioned by the NCLR for its Phoenix convention, some 74% of Latinos will consider “a candidate's relationship with the Hispanic community and record on Hispanic issues” when deciding how to vote.

That might not matter in solidly Republican Texas or solidly Democratic California, even though Latinos make up a third of the population in both states. But the Zogby finding could be crucial in several “battleground” states.

In New Mexico, for example, where 43% of the population is Latino, Mr Bush lost to Al Gore in 2000 by just 366 votes; in Oregon, with 55,000 registered Latino voters, Mr Bush lost by fewer than 7,000 votes; in Washington state, where the Latino population doubled during the 1990s to around 8% of the population, Mr Gore's winning margin was only five percentage points; and in Iowa, where 3% of the population is Latino, Mr Bush's share of the 2000 vote was just one percentage point less than Mr Gore's. Most important of all, given its 27 electoral-college votes, could be Florida, where 17% of the residents are Latino and Mr Bush's margin was a fraction of a percentage point.

So what are “Hispanic issues”? Usually the same as anyone else's. Top of the list in the Zogby poll is education, chosen as the most important issue by 34% of the sample; next comes the economy and jobs, chosen by 22%. Immigration, traditionally the most Latino issue of all, comes third, chosen by 8% of the sample (with most Latinos strongly favouring a generous welcome to newcomers).

In theory, Mr Bush has nothing to fear on these issues. The 2002 No Child Left Behind Act, for example, was specifically designed to help disadvantaged children. That surely includes Latinos: only 73% of Latinos between 16 and 24 have graduated from high school, compared with 89% of blacks and 93% of whites. Similarly, Mr Bush can point to an improving economy and to his call in January for reforming the immigration system to give temporary documentation to illegal immigrants.

In practice, however, Mr Bush may be fretting. The No Child Left Behind Act has so far done nothing to improve Latino test-scores. Indeed, some say that its emphasis on testing actually discriminates against Latino children. As to the improving economy, it may be improving a bit too late and a lot too unequally to win the votes of Latinos who were already near the bottom of the economic pile, with an average household income of just $33,103 in 2002, compared with $46,900 for white households and $29,026 for black ones.

As Mr Kerry told his Phoenix audience, “In the last three years, Hispanic-American unemployment has soared more than 30%...and millions and millions of hardworking Hispanics who have jobs aren't getting paid enough to pay the bills.” Add a Kerry blast at outsourcing and tax-breaks for the super-rich, plus a pledge to provide health insurance for almost everyone (a third of Latinos have no cover, compared with 15% for Americans overall) and Mr Bush may well feel discomfited.

Mr Bush's most vulnerable point may well be immigration. His January proposals were just that—proposals, with no legislative follow-up. While they aroused the fury of anti-immigrant Republicans such as Tom Tancredo, a Colorado congressman who suspected a path to amnesty, they disappointed Latino leaders because they opened up the possibility of deportation.

Mr Kerry says that as president he would send to Congress within 100 days a bill offering legalisation to long-staying, tax-paying illegal immigrants, helping family reunification and providing a path to permanent residence or citizenship. He would also approve laws to grant legal status to undocumented farm workers, and a bill to allow some 65,000 high-school graduates, illegally resident in America, first to go to college with the same fees or aid as their legal peers and then to achieve citizenship. Given that this week the Border Patrol, straying far from its normal terrain, was rounding up illegal immigrants in places around Los Angeles, Mr Kerry's stance resonated at the NCLR.

Disloyal Democrats

But will his promises be enough to keep Latinos reliably Democratic? The Latino vote seems to be particularly volatile. For instance, after Saddam Hussein was captured in December 2003, the proportion of Latinos saying they would vote for Mr Bush jumped ten points to 37% in the Pew Hispanic Centre's poll; the figure for the “Democratic candidate” (Mr Kerry was not named back then) fell nine points, to 47%. Moreover, the very diversity of Latinos makes their loyalty complicated. They identify with lands of origin from Chile to El Salvador, Puerto Rico (whose population are citizens by right) and Cuba. And any number of foreign-policy decisions can affect their opinions.

Two in three Latinos, however, are of Mexican origin. Hence Mr Bush's wooing of Mexico's president, Vicente Fox, and Mr Kerry's pledge to work together with Mexico and to set up a Clintonian-sounding “Community of the Americas”. But many Latinos are illegal, and so voteless, others are not even registered and their Democratic loyalty is no longer total.

In California's election to recall the governor last year, 30% of Latinos voted for Arnold Schwarzenegger, and another 9% for another Republican, Tom McClintock—even though they were running against a Latino Democrat, Cruz Bustamante. Meanwhile, in Florida, the Cuban population is reliably Republican (helped by Mr Bush's toughening of anti-Castro restrictions) and the non-Cuban Latinos are warming to Governor Jeb Bush, the president's brother.

In the end, the Latino influence in November may depend on the turnout: given their (slight) preference for voting Democratic, the more they vote, the better it will be for Mr Kerry. The NCLR reckons some 7.9m Latinos may actually vote this year (7% of the likely turnout), compared with 5.9m in 2000 (6%).

Hardly a dramatic difference (and other forecasters reckon the Latino figure this year will be below 7m). But with each election, the Latinos are wooed ever more aggressively. But they have yet to turn that allure into political clout. As one delegate to the NCLR put it, “We've grown cynical of government, and of both parties.” He compares Anglo politicians to the *chupacabra*, a mythical Mexican goat-killing monster that emerges every now and then to suck the blood of its victims.

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The electoral week

On the trail

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Dick talking

“Well, I expressed myself rather forcefully, felt better after I had done it.”

Dick Cheney explains why he instructed Senator Patrick Leahy to “fuck yourself” after he was asked about Halliburton; by coincidence, the Senate passed the “Defence of Decency Act” on the same day. Your World with Neil Cavuto, Fox News Network, June 25th

The Devil came down to Georgia

“I think he has sold his soul for a mess of pottage.”

Democratic Congressman John Lewis on reports that Zell Miller, a conservative Democratic senator from Georgia, will speak at the Republican convention. Associated Press, June 25th

The great conspiracy

“The 22nd amendment says that the president can only be elected twice or if you succeed as vice-president you can only serve if you serve like a day more than 18 months or a day more than 2 years, then you can only be elected once. So arguably, a former president could become vice-president.”

Bill Clinton on his veep chances. Larry King Live, CNN, June 24th

Identity crisis

“I double checked with the sergeant co-ordinating the investigation to make certain he confirmed the identity and that the suspect was not just joking with us.”

A Fort Myers police spokesman on arresting a boat salesman named George W. Bush on solicitation charges. Fort Myers News-Press, June 25th

The Party party

“We have girls from London, Seattle, California, all coming in for that week, it's the week everyone wants to work.”

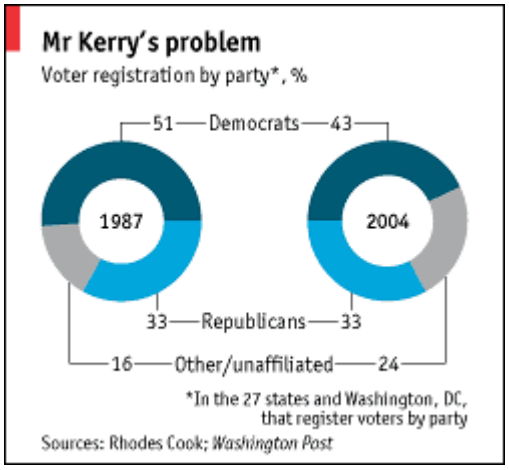
An owner of a Manhattan escort service on the expected expansion of business during the Republican convention. New York Daily News, June 28th.

Heil Kerry

“This ad is the campaign equivalent of ‘The Producers'—an idea so

egregiously tasteless and stupid that it might just succeed as camp....I should be disgusted by the attempted association of Democrats and Nazis, but it's too funny to get upset about. Cue the goose-stepping *Mädchen* of the Brookings Institution!"

Jacob Weisberg on the Bush-Cheney campaign website's use of pictures of Adolf Hitler between photographs of prominent Democratic politicians. www.slate.com, June 28th



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John Kerry's running-mate

Take a chance on me

Jul 1st 2004 | WASHINGTON, DC
From The Economist print edition

A guide to the runners in a race that will do much to determine the nature of John Kerry's campaign this autumn

Get article background

AP

REPORTERS dog John Kerry's steps asking the question. The candidate spends hours calling Democratic bigwigs for their opinion. The Hotline, a website for Washington insiders, counts no fewer than 71 candidates. Yes, it is summer in election year and gossip lightly turns to thoughts of the challenger's running-mate.

For a few thrilling weeks, it seemed as if he was going to run on a ticket of national unity. In the first national election after September 11th and the Iraq war, Americans seemed to yearn for something above the traditional partisan bickering. What better way to dramatise national unity than by choosing a Republican?

Step forward **John McCain**; but alas, the Arizona senator is now campaigning for George Bush. A few lesser Republican lights continue to gleam fitfully, but none of them seems likely to get voters to change sides. So having been stumped for a "break out" running-mate, Mr Kerry has returned to business as normal. And the big question for him is not so much who he will choose, but does he pick someone to reinforce or to reinvent his campaign?

In the past, business as normal has meant choosing a favourite son to deliver a state or region. Two possibilities are the senators from Florida, **Bill Nelson**, a lawyer who once went up in the Space Shuttle, and **Bob Graham**, who is retiring, whose bid for the presidential nomination flopped but who is Florida's last Democratic icon. The trouble is that neither would be guaranteed to win even their own state, let alone the South, and the last vice-president to deliver a regional block of votes was Lyndon Johnson, in 1960.

So Mr Kerry is much more likely to make a choice based on the character of his campaign overall. So far, that campaign has been boring but sensible. Though his rhetoric is sometimes excitingly over the top ("the most reckless, inept, ideological foreign-policy in American history"), Mr Kerry is campaigning as a steady mainstream Democrat. No dramatic policy proposals, few political risks; this has been a stealth candidacy.

The temptation to continue that way is strong. As a senator, Mr Kerry has anyway always campaigned like one of those cyclists who stay in the pack and save the mad sprint to the end. If Iraq does not suddenly improve and if voters continue to ignore good news on the economy, as they are doing, then he need take no further risks. Mr Bush will defeat himself. Such a line of thought suggests **Dick Gephardt**, the former Democratic leader in the House, would be the logical pick.

He is Democratic respectability incarnate, with 27 years of service in Congress to add to Mr Kerry's 19 in the Senate. His experience makes him a credible president if anything were to happen to Mr Kerry. This is not something to be downplayed as a criterion: Bill Clinton, when he ignored advice to "balance the ticket" and chose Al Gore, another moderate young southerner in 1992, is reputed to have explained: "I might die." As added bonuses, Mr Gephardt comes from the swing state of Missouri (though he has never won statewide there), retains some appeal among trade unions and could shore up Mr Kerry's left against

Ralph Nader, without being cast as a Deaniac extremist.

Another blue-collar mid-westerner from a swing state, **Tom Vilsack**, the governor of Iowa, also looks a safe pair of hands. He is a little closer to the centre, and, though he lacks national experience, is a good campaigner. Senator **Joseph Biden**, the ranking member on the Senate Foreign Relations Committee, is a credible presidential deputy, though Mr Kerry is already sure to win Mr Biden's home state of Delaware.

The trouble with the Missouri compromise is that it is negative: the strategy depends on Mr Bush continuing to flounder. But what if “Anyone but Bush” were no longer enough, and Mr Kerry needed to attract waverers? Then he surely needs somebody who is a better campaigner, who can connect more successfully with voters and bring a missing jolt of energy to the campaign. This is the argument, above all, for **John Edwards**.

For many Democrats, the telegenic Mr Edwards is Bill Clinton without the scandals. In the primaries, he showed himself to be a great stump speaker. Since then, he has been an assiduous surrogate for the Kerry campaign, campaigning openly for the vice-presidential slot. Watching the crowds surge round Mr Edwards, one local party leader said it was the nearest thing he had seen in politics to Elvis.

Mr Edwards is a southerner, but unlikely to move any southern states out of Mr Bush's camp in the presidential contest. He might, however, help Democrats retain southern Senate seats (such as his own North Carolina). More important, he has proven appeal among rural and suburban voters in mid-western states that Mr Kerry must win, like Ohio. On the other hand, Mr Edwards has a grand total of five years in politics; he has won just one election; and relations with Mr Kerry seem uneven.

So while it is possible that, like Mr Reagan in 1980, Mr Kerry will finally settle on the man he beat in the primaries, he is first likely, argues Norm Ornstein of the American Enterprise Institute, to look for someone who combines the virtues of both safety first and a jolt to the ticket. As it happens, dark horses exist. One is **Mark Warner**, the governor of Virginia (another southerner) who has raised taxes and closed the state-budget deficit with the help of Republicans. Another darker horse is **Robert Rubin**. Mr Clinton's former treasury secretary has never run a campaign, and could certainly be painted as another elitist north-easterner. But the architect of the now fondly remembered Clinton boom and budget surpluses has international gravitas (more than Mr Kerry) and would provide an unexpected jolt of unconventionality to the campaign.

Lastly, there is the darkest horse of all: **Hillary Clinton**. She is pretty much a category all of her own, representing most of the advantages of the others and many of the disadvantages too. There would be no surer way to end the stealth candidacy.

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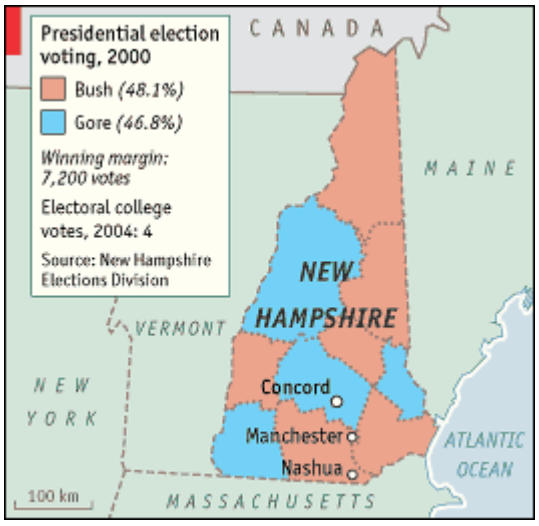
Swing states: New Hampshire

The granite prize

Jul 1st 2004 | CONCORD, MANCHESTER AND PORTSMOUTH
From The Economist print edition

Welcome to prosperous, truculent New Hampshire, where newcomers in the south are upsetting predictions



EVERY fourth January, when it holds the first presidential primary, New Hampshire becomes the centre of American politics. Presidential hopefuls brave frigid temperatures to court the state's 900,000-odd voters. And then they disappear. New Hampshire looks too small and generally too Republican to warrant much attention. Not this year. The Democrats think they can snatch a state that George Bush won by just 1.27% in 2000 and, in a close election, its four electoral-college votes could prove crucial.

New Hampshire has long been a bastion of Republicanism in the liberal north-east. Although the state went for Lyndon Johnson and Bill Clinton, it has otherwise voted for Republican presidents for generations. But its politics are libertarian rather than socially conservative. It is an affluent place (its median income is the fourth-highest in the country), full of well-educated folk who hate taxes: there is no state income tax or sales tax. Yet it is generally moderate on social issues. A majority of New Hampshire's voters, including 35% of its Republicans, support gay marriage. George Bush's southern-fried conservatism plainly worries people.

Meanwhile, more voters are now registered as independents (38%) than Republicans (37%) or Democrats (26%). This largely reflects the state's changing demographics. Helped by those low taxes, New Hampshire—particularly its south-eastern section—has lured in plenty of upmarket service jobs, many of them in finance and technology. It has also flourished as a commuter belt for Massachusetts: central Boston is less than an hour away by car. According to the University of New Hampshire Survey Centre, only one in three adults in the state was born there, and a quarter were born in Massachusetts.

These newcomers in the southern part of the state are hard to read, but definitely more liberal than the natives of a generation ago. They supported Bill Clinton in 1992 and 1996; they were wowed by John McCain in the 2000 primaries and underwhelmed by both Mr Bush and Al Gore. (The latter would have won the state, according to one high-placed Democrat, if he had let Mr Clinton campaign on his behalf in New Hampshire.)

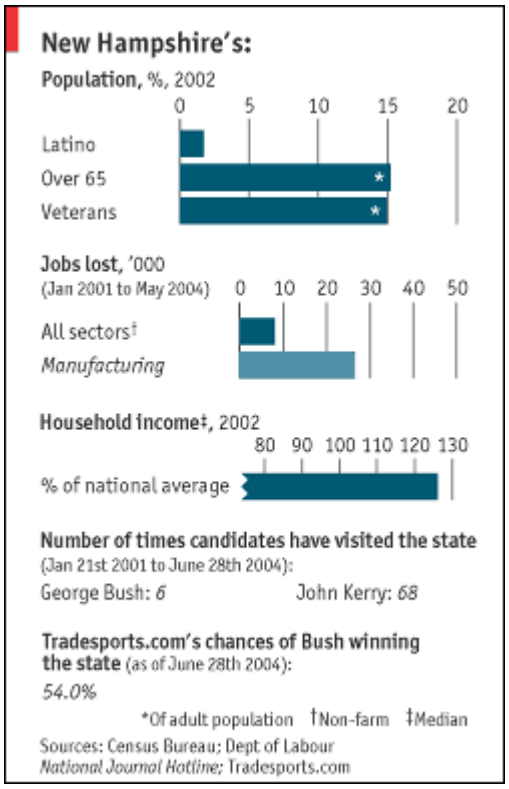
The issue that will sway these swing-voters is the economy. At first sight, that should boost Mr Bush's chances. New Hampshire has weathered the downturn relatively well: its unemployment rate of 4.0% is well under the national rate of 5.6%. That stands in stark contrast to the 1991-92 recession, when the state suffered a wrenching property bust—and promptly took revenge on Mr Bush's father.

But, so far at least, New Hampshire's relative recent prosperity has not helped the current president. Most polls put the two candidates in a dead heat, and John Kerry has even appeared in the lead. A poll in mid-June by the American Research Group, which is based in Manchester, gave Mr Bush a job-approval rating of 41%, its lowest level of his presidency.

Iraq certainly plays a role in this: New Hampshire has a relatively high share of reservists and around half of them have been called to service, one of the highest call-up ratios in the country. But the big issue with those swing-voters in the south seems to be jobs. It is not that employment is hard to find, but that good jobs seem scarce. Democratic activists say their target swing-voter is an educated

professional who is worried about rising college fees and health-care costs.

For Mr Kerry to succeed, these swing-voters must vote overwhelmingly Democratic. According to Andrew Smith, director of the University of New Hampshire's survey centre, Mr Bush can win with 80% of the registered Republican vote and 40% of the independents. Mr Kerry, by contrast, needs 90% of the Democrats, 15-20% of the Republicans and two-thirds of the independents.



Can he do it? After some two decades as the senator from neighbouring Massachusetts, almost everyone in New Hampshire has heard of Mr Kerry; he is a quasi-home-town candidate. On the other hand, many New Hampshire voters fled high-tax Massachusetts, and they are deeply suspicious of tax-and-spend liberals. Although most people know his name, Mr Kerry is "still somewhat undefined", as Jennifer Donahue, a political analyst at St Anselm College in Manchester, puts it. Mr Bush's campaign is trying hard to fill the gap. It has spent a lot of money on television ads, many of them painting Mr Kerry as a high-spending, flip-flopping liberal.

The Bush challenge

In a race this close, grass-roots organisation will count for a lot. The Bush-Cheney campaign headquarters has been open since the beginning of the year; there are Bush-Cheney campaign chairmen and even "e-campaign organisers" in every town. The state Republican Party is in good shape, controlling every statewide office of any note. Though the governor, Craig Benson, may face a serious Democratic challenge, the state's senior senator, Judd Gregg, is a shoo-in. (Mr Gregg's Democratic challenger recently dropped out after a corruption scandal; now he faces "Granny D", a 94-year old woman, famous for walking across the country to promote campaign-finance reform.)

But the Democrats are better organised that they have ever been before—and far angrier. The popular former governor, Jeanne Shaheen, is the national chairman of Mr Kerry's campaign. Lower down swarm all the activists working for Bush-loathing "527" organisations (named after a section of the tax code) and stirring up Democratic voters. Mr Bush has the upper hand, but his margin for error is slim.

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Moore's law

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From The Economist print edition

The success of his new film is bad news for George Bush. But is it good news for the Democrats?

DURING the first three years of the Bush administration the White House rolled over liberal America relentlessly. George Bush began with surprise on his side: the Democratic Party never expected a "compassionate conservative" with a doubtful mandate to morph into a fiery apostle of tax cuts. After September 11th, he benefited from the instinct to rally round the flag. And then he had the Democrats' fear of being seen as wimps when it came to dealing with Saddam Hussein.

But liberal America is no longer willing to be rolled over. Bookshops are piled high with Bush-bashing tomes. Democrats in Congress have more fire in their bellies than they have had in years. John Kerry has already raised more money than any presidential challenger. George Soros is pouring millions into Democratic think-tanks and pressure-groups.

This liberal counter-insurgency has its own pudgy Che Guevara. From the moment Mr Bush "stole" the election from Al Gore, Michael Moore launched fusillades against "the thief in chief". "Stupid White Men", whose publication was delayed by September 11th, went on to sell around 4m copies worldwide. Mr Moore is the perfect antidote to dreary diatribes in the *Nation*, a man who believes there is no contradiction between left-wing politics and popular entertainment.

"Fahrenheit 9/11" is Mr Moore's harshest blast against Mr Bush yet. The film has already garnered the Palme d'Or at the Cannes film festival (along with a 20-minute standing ovation). It made $24m on its opening weekend in America.

It must be said that, as cinema, the film is not up to the standards of "Roger and Me", Mr Moore's anti-capitalist documentary of 1989, in which he stalks Roger Smith, the General Motors suit who had closed a plant in Mr Moore's hometown of Flint, Michigan. Nonetheless, it gathers some fascinating footage. Mr Moore's vicious wit scores points, as in the scenes of Paul Wolfowitz slobbering saliva over his comb and John Ashcroft warbling a patriotic ditty. His portrayal of the attack on the World Trade Centre—sound only against a blank screen as the planes hit the towers—is a stroke of genius. And Mr Moore can spark genuine outrage even amongst Republicans: what on earth *was* the White House doing shuttling the bin Laden family out of America straight after the terrorist attacks?

Yet "Fahrenheit 9/11" is unlikely to change anybody's mind. Mr Moore takes too many cheap shots.

Wanting to accuse the president of stupidity and idleness, but also of shrewd and unceasing efforts in the cause of evil, he keeps contradicting himself. He lashes Mr Bush for spending too much time on holiday, and then shows him hobnobbing with Tony Blair at Camp David. (Maybe, just maybe, they were discussing affairs of state.) He presents Saddamite Iraq as a land of jolly weddings and kite-flying children. He flirts—or appears to flirt (his method is to insinuate not assert)—with deranged conspiracy theories. Can he really be implying that the White House, and the sinister forces it strives to serve, were glad that September 11th happened?

In so far as the film has a central argument, it is that the war on terror is a confidence trick. Mr Bush is not serious about homeland security, let alone about tackling bin Laden and his Saudi friends. He is simply using terrorism as an excuse for keeping the population in a state of panic while launching a grab for Iraqi oil. Mr Moore ends the film reading a passage from George Orwell's "1984" about how the purpose of war is not to defeat the enemy but to keep your own people subjugated.

What does Mr Moore's success at the box office say about American politics and American opinion? Plainly, it says that Mr Bush has failed to build a national consensus behind his war on terror. This is partly his own fault. Back when his job-approval ratings were at 90%, he cut taxes in ways that conspicuously favoured the rich, even as he called the nation to arms: so much for shared sacrifice in a noble cause. (In a telling passage in the film, Mr Moore innocently urges conservative congressmen to enlist their children in the armed forces and send them to Iraq; he claims only one congressional child is serving there.) Mr Bush also exploited the war on terror for partisan gain in the 2002 congressional elections. His approval ratings are now around 45%, support for the war is waning, and Mr Moore's views have moved from the margins of the disaffected to a cinema near you. You could say that the White House is reaping what it sowed.

The deafening silence of John Kerry

But "Fahrenheit 9/11" also has some worrying implications for the Democrats. It reminds middle America that liberal activists like to blame their own country for the world's problems. So far no prominent Democrat has seen fit to denounce Mr Moore's view that the war on terrorism is a fraud (the silence from John Kerry has been deafening). Instead, party elders including Tom Daschle and Terry McAuliffe attended the film's premiere in Washington, DC, and other Democrats have helped publicise it.

Mr Moore is a dangerous man to flirt with: remember how Wesley Clark's campaign collapsed when Mr Moore simultaneously endorsed the general and described Mr Bush as a deserter? Mr Moore has a long record of denouncing the United States to foreigners. The Republicans are citing him as proof of their charge that the Democrats are "a coalition of the wild-eyed". If they have any sense, they may even steal a Moore cinematic technique: show the Democratic elite traipsing along the red carpet to see "Fahrenheit 9/11", and then cut to a grainy shot of Mr Moore telling Britons that Americans are "possibly the dumbest people on the planet."

Mr Moore is a formidable ally if all you want to do is attack Mr Bush. But the Democrats want to govern the country. With Messrs Bush and Kerry running neck-and-neck in the polls, they should be careful whom they hang out with.

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Canada's election

Martin's new age of minority

Jul 1st 2004 | OTTAWA
From The Economist print edition

AP

The voters punish, but reprieve, the Liberals. Now the prime minister faces a difficult tactical challenge

Get article background

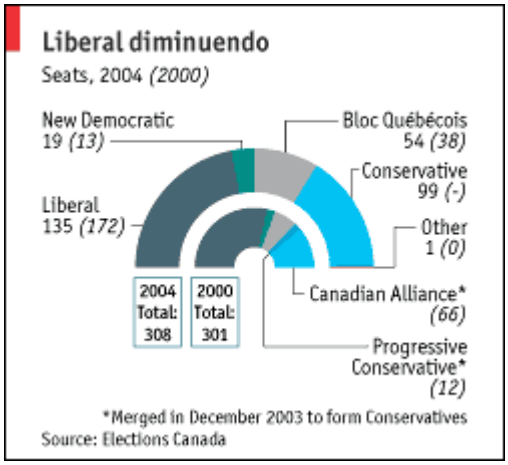
IT WAS far from the powerful personal mandate that was Paul Martin's overriding goal ever since he replaced Jean Chrétien as leader of Canada's Liberal Party and thus as prime minister late last year. But neither was it the drubbing that pollsters had predicted. The Liberals lost 37 seats in the general election on June 28th, and with them their majority in the House of Commons. But even after 11 years in power, they remain the largest party. Stephen Harper, the leader of the newly united Conservatives, saw his hopes of government dashed. Nevertheless, though the Liberal vote held up far better than opinion polls had suggested, the party was still humbled. “The message was unmistakable: Canadians expected, and expect, more from us,” said Mr Martin.

The prime minister insists he will eschew a formal coalition, and will lead a “stable” minority administration, seeking support where he can find it. A first-past-the-post electoral system in a country of strong regional differences means that Canada is familiar with minority governments, though it has not had one for a generation. Financial markets barely blinked.

Most minority governments have lasted for 18 months or so. Some have done even better. At a post-election news conference, Mr Martin recalled that Lester Pearson, one of Canada's most revered prime ministers, led minority Liberal governments for five years in the 1960s.

The new balance of the parties is much as it was then, with one big exception. The separatist Bloc Québécois won by a landslide in its French-speaking province—not from a surge in support for Quebec's independence, but because of anger over a scandal under Mr Chrétien in which a programme to promote federalism turned into a slush fund for Liberal cronies. To regain the trust of Quebeckers, the Liberals will have to show “honesty, integrity and

a deep respect for taxpayers' dollars", says Mr Martin, whose own seat is in Quebec.



Elsewhere, surprisingly little changed. In the popular vote, the Liberals led the Conservatives by 7.1%, and by 13% in Ontario, the most populous province. The leftish New Democratic Party (NDP) under Jack Layton, a vigorous new leader, almost doubled its share of the vote, but won only six more seats.

What saved the day for the Liberals was that many voters in socially tolerant Ontario were scared of Mr Harper's Conservatives, a party cobbled together from his own right-wing Canadian Alliance and the more moderate Progressive Conservatives. The Liberals and the NDP succeeded in arousing fears that the Conservative platform concealed ambiguities on abortion and that neither Medicare nor the Charter of Rights and Freedoms would be safe in the party's hands. Mr Harper, a cerebral economist from oil-rich Alberta, had dominated the early weeks of campaigning with attacks on Liberal corruption. But he aroused ire when he suggested that Mr Martin was soft on child pornography.

After weeks of hesitant lethargy, Mr Martin came alive in the campaign's final days. He flung himself into a coast-to-coast dash to support candidates in tight fights. He began touting his successful record in ten years as finance minister under Mr Chrétien, casting aside his previous pretence that the two men (who abhor each other) had no links. Meanwhile, Mr Harper, apparently confident of victory and having set a transition team to work, eased off; on the campaign's final day, he took a lengthy bus ride through Alberta.

In the end, Canada swung slightly to the left, rather than to the right. At the last election, the vote for the two separate conservative parties totalled 38%; the merged party managed only 30%. The Liberals' most willing allies are the NDP; Mr Layton said he wants "a significant role". Between them the two parties will be just one seat short of a majority (or two, if they provide the speaker).

The leftward tilt is a challenge for Mr Martin, a businessman who as finance minister balanced Canada's books, cutting both taxes and spending. This week, he sounded sanguine. There was broad agreement on his top priority, more health spending, he said. He will seek support for his health-care plans at a meeting with provincial premiers. A promised child-care scheme should attract support from the NDP and the Bloc Québécois, but both have a long wish-list of other new spending pledges. Clashes are likely, too, over defence (even though the hawkish defence minister lost his seat). Mr Martin wants Canada to take part in the Bush administration's plans for an anti-missile shield; the NDP and the Bloc are opposed. The NDP, but not the Bloc, will push for moves towards proportional representation.

Parliament is unlikely to be convened until late September, so Mr Martin has plenty of time to ponder. His first challenge will be to approve a budget next February. Otherwise, he will have to seek support issue by issue.

To do this, he has one big weapon. None of the other parties, except perhaps the NDP, would relish another election soon. The Bloc is unlikely to do as well next time. The Conservatives need time to consolidate their new party and steer it to the centre: they will hold a policy conference in September. Making the most of his weapon will require tactical skill of an order that has been invisible since Mr Martin took over the top job. Unless he now reveals it, the Liberals' defeat may just have been postponed.

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Argentina

Pickets and police

Jul 1st 2004 | BUENOS AIRES
From The Economist print edition

AP

Kirchner's dilemma over the piqueteros

THE timing could not have been more ominous. As thousands of *piqueteros*—jobless protesters—gathered to mark the killing by policemen two years ago of two of their number, one of their leaders, Martín Cisneros, was shot dead in La Boca, a rundown area of Buenos Aires. In 2002, anger at the killings and fears of further disorder prompted Eduardo Duhalde, then Argentina's president, to cut short his term in office. This time, sympathy for the *piqueteros* has been more muted; but fear of disorder is just as great. How to deal with the protesters is turning into a big headache for Néstor Kirchner, Mr Duhalde's successor as president.

The *piqueteros* grew into a mass movement during Argentina's financial collapse of 2001-02. As the economy recovers, unemployment has fallen, but still stands at 14%. Some of the *piquetero* leaders now manage a range of government-financed social projects. But the movement has split into warring factions—and some of them are keen on confrontation.

Mr Kirchner has refused to repress the *piqueteros*, arguing that they will eventually wear themselves out. There is some evidence of that: the number of roadblocks—a traditional form of protest—has fallen by more than half since 2002. But in recent weeks small extremist groups have tried more radical tactics. They have organised the occupation of motorway toll booths and nine branches of McDonald's, and damaged the headquarters of Repsol-YPF, a Spanish-owned privatised energy firm. After Mr Cisneros's death, members of his faction smashed up a police station.

Many Argentines now want the government to get tough. According to Ricardo Rouvier, a pollster, almost two-thirds disapprove of Mr Kirchner's handling of the protests. But around half say they do not favour violent repression.

“We are not going to use a trigger-happy police force to repress social protest,” Mr Kirchner insisted last week. He has a point. A police commander was accused of shooting one of the *piqueteros* murdered in 2002; the police may also have had a hand in Mr Cisneros's killing.

But Mr Kirchner still faces a dilemma. On the one hand, some of the *piquetero* leaders want to provoke acts of repression, in order to create martyrs. Controlling the protests without violence would be hard for even the most sophisticated police force, which Argentina's most certainly is not. On the other hand, passivity in the face of the protests adds to a sense of lawlessness. Argentines worry about a crime

wave. And the occupation of foreign-owned businesses will do nothing to draw new investment into Argentina.

To make matters worse, there are signs that the *piqueteros* are now being used in a long-running battle between Mr Kirchner and Mr Duhalde for control of the ruling Peronist party's machine in the Buenos Aires rustbelt. A congressional election next year will bring that battle to a head. Some of Mr Kirchner's supporters believe the latest murder was intended as a warning to the government. Whether or not that is true, the *piquetero* problem is showing no sign of fading away just yet.

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Cuba and the United States

Unhappy families

Jul 1st 2004 | HAVANA
From The Economist print edition

Is Fidel Castro about to score another propaganda victory?

Get article background

AP

For Cubans, less manna from Miami

THE story of Elián González, a small, shipwrecked Cuban boy who was at the centre of an international custody battle in 2000, should have taught even the most militant American opponent of Cuba's Communist president, Fidel Castro, that splitting families makes for bad politics. It seems not to have done.

With his eye on holding Florida in this year's presidential election, George Bush has tightened the rules on contacts between Cuban-Americans and their families back on the island. From June 30th, Cuban-Americans can make only one two-week visit every three years, instead of unrestricted annual visits. They will not be able to send as much money to people on the island, and none beyond their immediate families. All humanitarian visits have been scrapped.

Mr Castro has been searching since the “battle of Elián” for another issue on which to rally Cubans and deflect international criticism away from his own refusal to allow dissent against his government or a free election. He clearly reckons he has found it. “Pitiless” and “brutal”, he exclaimed about the new American measures at a rally of thousands of Cubans—Elián and his family among them—last week outside the United States' diplomatic mission in Havana. A few weeks earlier, the dictator had led 1m people past the building.

Mr Bush says that limiting the flow of dollars to Cuba will hasten the overthrow of Mr Castro's regime—a familiar argument used by previous presidents to justify America's failed trade embargo on the island. But the latest measures will hit precisely those whom the Americans might be expected to want to help, such as the owners of beleaguered family businesses. Some small restaurants and bed-and-breakfast houses, many of which depend on trade from Cuban-Americans, say business is down by as much as half. Some Cubans on both sides of the Florida Straits are already looking for third-country routes to bypass the measures.

And the new policy may not, in fact, help Mr Bush much in the election. In the past two decades, Florida's Cuban community has doubled in size, with the arrival of 400,000 mainly economic immigrants. These have strong family ties at home; many are furious about the new restrictions. John Kerry, Mr Bush's Democratic challenger, says he would allow unlimited family visits if elected. That could be the vote-winner.

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Mining and tax

A right royal row

Jul 1st 2004 | LIMA AND SANTIAGO
From The Economist print edition

Chile and Peru are right to levy royalties on mining—but the devil is in the detail

FOR centuries mining has formed the economic backbone of several Andean countries. It provides vital foreign exchange—40% of Chile's export income last year and half of Peru's. But it is a capital-intensive business. In Chile, it employs only 74,000 people; in Peru, miners form a mere 1% of the labour force. To its critics, mining leaves little behind except some big, and often polluted, holes in the ground.

In the recent past, both Chile and Peru were desperate to attract mining investment to revive their economies. Chile's investment law of 1974 was decreed by the dictatorship of General Augusto Pinochet and remains little changed. It grants tax stability for at least ten years for any new venture. Many mining companies in Peru signed similar deals with the authoritarian government of Alberto Fujimori.

Now, with world prices for minerals close to their highest levels in a decade, democratic politicians in both countries want mining companies to pay more tax. In early June, Peru's Congress approved (by 90 votes to 11) a law to levy royalties of up to 3% on sales of mineral concentrates. Chile's government announced in April that it was about to send to Congress a similar measure. But no bill has yet emerged: government lawyers are trying to find ways to ensure that it will survive the scrutiny of the Constitutional Court.

Neither government is enthusiastic about royalties, but in both countries they make for good politics. In Peru, the weak government of Alejandro Toledo reluctantly promulgated the law a fortnight ago. That prompted several of the industry's biggest names, including Anglo American and Southern Peru Copper Corporation, to pull out of an auction due on July 23rd for the right to develop Las Bambas, a huge copper deposit in southern Peru.

Mining bosses complain that “tax stability” is being torn up. In a memo, Jean Paul Luksic, the chief executive of Antofagasta, a London-registered mining firm, argues that the Chilean proposal “runs contrary to the letter and spirit” of existing mining concessions. The bill “would call into question the strong reputation which Chile has established as...the most stable and reliable investment destination in Latin America.” He adds that mining firms continued to invest when prices were low and should not be penalised now.

Supporters of the measures put forward two main counter-arguments. First, there is a strong case in principle for governments to charge royalties on mineral extraction, as Eduardo Engel, a Chilean economist at Yale University, points out. Mining companies are depleting a non-renewable resource. In most cases, their profits include “economic rents”, as economists call payments made to those who control resources whose supply, in the short term, does not vary with their price. On grounds of fairness, governments usually seek to share out those rents by taxing them. Some Canadian provinces, American states and Australia already levy royalties on mining.

Second, in Chile in particular, many mining companies pay almost no tax, because the law allows big write-offs for “accelerated depreciation” and other loopholes. Chileans were scandalised in 2002 when Exxon Mobil, an American firm, sold Disputada de las Condes, a copper company, to Anglo American for $1.3 billion; for the previous quarter-century Disputada had reported losses, so Exxon paid virtually no tax. Antofagasta made pre-tax profits of $357.2m in 2003 and $176.8m in 2002. Its bill for corporation tax was $58.9m in 2003 and $28.3m in 2002, yet its accounts state that tax paid was only $9.6m and $3.2m respectively.

But even if royalties are justified in principle, the devil is in the detail. Of the two bills, Peru's is the clumsier. By taxing sales of concentrates, it takes no account of the price cycle: firms will have to pay

even when they are making losses. Some would escape royalties, either because they produce unprocessed ore (rather than concentrates) or because they have signed agreements that prohibit tax changes. But others might have to pay twice: the Las Bambas deposit is to be awarded to whichever firm offers the highest royalty above 2%; under the new law, the winner will have to pay a further 3% on top. Peru's government has sent a new bill to Congress that would rectify these problems.

Chile's draft bill avoids these pitfalls. It would levy royalties (of up to 3%) only on firms with operating margins of over 5%. For the first three years, this would take the form of a credit against corporation tax. Officials say this means that the royalties will apply only to new investments, not existing ones. But mining firms are right that, in practice, this is still a change in the rules of the game. Nicolás Eyzaguirre, the finance minister, counters that the firms blocked efforts at a voluntary agreement to pay more taxes.

In Chile, the government expects to raise at least $100m a year; this will go into a special fund to promote innovation. In Peru, royalties should raise some $75m; less sensibly, this will be shared out among local governments in mining areas.

Mining firms claim that the royalties will deter investment. Probably not in Chile: it ranked as the world's most attractive destination for mining investment in a survey in January by the Fraser Institute, a Canadian think-tank. Mr Eyzaguirre points out that, at a copper price of 90 cents per lb (it is now $1.19), the royalties would reduce the industry's average return on assets only from 20% to 19.2%. This would have “no impact” on investment.

Peru risks a bigger impact: although it ranked fifth (out of 53) in the Fraser Institute index, its politics are more unstable than Chile's. And both governments will have to work hard to distinguish these economically justified measures from a crude nationalist backlash against foreign investment in the neighbourhood that this year has seen attempts to revive state oil and gas firms in Argentina and Bolivia.

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China and Hong Kong

The parade gets rained on

Jul 1st 2004 | HONG KONG
From The Economist print edition

China finds some ingenious new ways to frustrate Hong Kong's democrats

Get article background

THIS time, China's leaders were better prepared. By a series of well-timed moves, they took some of the sting out of a huge demonstration for universal suffrage. The democrats' protest on July 1st—a public holiday marking Hong Kong's handover to China in 1997—attracted hundreds of thousands of people. The immediate political impact will not be as great as the fallout from a similar march a year ago. But it will still give China's leaders and their Hong Kong supporters pause.

Last year, the democrats startled both the Hong Kong government and China's central leadership in Beijing by pulling about half a million people into a protest chiefly aimed at a proposed anti-subversion bill. That display of people power, unprecedented in scale since the handover, led to resignations from Hong Kong's cabinet and the shelving of the bill.

A year on, Hong Kong's people still have as much to complain about. In April, China's legislature, the National People's Congress, ruled that there could be no universal suffrage in Hong Kong for at least another eight years, despite opinion polls showing overwhelming support for its early introduction. The mysterious resignations in May of three radio talk-show hosts critical of China's policies in Hong Kong increased widespread suspicion (never proven) of an intimidation campaign by communist sympathisers against democrats. A couple of weeks before the July 1st protest, Hong Kong's police force detained seven Chinese suspected of being mainland security agents conducting an unauthorised investigation—a cause of alarm for the many Hong Kongers who regard the territory as a haven from the mainland's arbitrary legal system.

The demonstration was still under way as *The Economist* went to press, with a procession of banner-waving protesters clad in white stretching for several kilometres through the central business district. Organisers had predicted a lower turnout than last year. But despite oppressive heat, the numbers were clearly massive. China had been bracing itself for this. By ruling out universal suffrage for years ahead, China had made it difficult for democrats to pursue the issue passionately without risking a probably doomed confrontation. The main pro-democracy parties have not abandoned their call for universal suffrage in 2007 to select the chief executive and 2008 the legislature; but they know they are very unlikely to get it.

China cleverly followed up its brusque dismissal of democratic reform with an unexpected display of friendship to its opponents. Critics in Hong Kong of the Chinese Communist Party were invited to meetings with Chinese officials who had previously shunned them. Then came hints that a long-standing ban on visits to the mainland by outspoken pro-democrats would be lifted. To avoid accusations of churlishness, pro-democracy politicians welcomed these moves, and drew up a new list of less provocative slogans for the July 1st march. Signs of economic recovery in Hong Kong also helped improve the mood, though the turnout suggests this has failed to dampen political aspirations.

China's leaders cannot afford to relax. Their battle with the democrats on the streets may have faded, but it lives on at the ballot box. There is still a strong likelihood that democrats will make considerable gains in the Legislative Council elections on September 12th. It is not inconceivable that, in spite of a system rigged to favour pro-China candidates, they might gain their first-ever majority. That would be a huge blow to China.

But Joseph Cheng, an academic and pro-democracy activist, says the democrats still need “a small miracle” to gain a majority. Even if they do, he adds, they should not underestimate the effectiveness of China's divide-and-rule tactics. One of the most prominent democrats, Szeto Wah, has publicly accused a well-known trade unionist, Lau Chin Shek, of being like “Judas” after Mr Lau made conciliatory remarks about China. Mr Cheng admits that the democrats are probably not well enough organised to cope with China's unexpected overtures.

After recent setbacks for its policies in Hong Kong—including a disastrous performance by its sympathisers in district elections last November—the Beijing leadership has stepped up its efforts to keep an eye on the territory's politics. A Hong Kong research institute was set up late last year in Beijing. Its well-connected director, Zhu Yucheng, has warned that, if the dispute over democratic reform continues, Hong Kong's social stability and economic revival could be jeopardised. He is right. But whose fault would that be?

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Indonesia's election

A singing contest

Jul 1st 2004 | MEDAN, NORTH SUMATRA
From The Economist print edition

And a mouthful of platitudes

Get article background

THE last big campaign rally for Wiranto, one of five candidates in Indonesia's presidential election on July 5th, ended as it began: with a singer in a hot-pink body stocking, jiggling her behind frantically to the appreciative roars of the crowd. In between, Mr Wiranto, a former general, briefly hectored the audience about his determination to bring security, justice and prosperity to the country. He then bellowed goodbye in one of the many languages of North Sumatra province, and broke into song himself.

For the past 40 days, the candidates have showered their supporters across Indonesia with stickers and T-shirts, songs and dances, platitudes and more songs. Mr Wiranto even duelled vocally with Susilo Bambang Yudhoyono, another former general, on the Indonesian version of “American Idol”, a talent-scouting television show. By Mr Wiranto's own account, Mr Susilo is the better singer. If the opinion polls are right—and they were during parliamentary elections earlier this year—he is also the better campaigner.

Reuters

Susilo is cruising to victory

The polls predict that Mr Susilo will romp home with more of the votes than the rest of the candidates put together. He might even stop the election from going to a run-off in September by winning more than half the vote in the first round.

A few months ago, analysts expected a much closer election. April's parliamentary poll delivered a fractured result, with no party winning more than a quarter of the vote, and six parties winning 7% or more. In North Sumatra, as elsewhere, Mr Wiranto's party, Golkar, came first, winning six out of the 29 parliamentary seats on offer. The party of Megawati Sukarnoputri, the incumbent president, was just behind, with five, and another five parties won three seats each.

Divided though Indonesians were then, however, most of them now seem to agree on Mr Susilo. His military background appeals to those who still reckon they need a strong leader, six chaotic years after the overthrow of Suharto, Indonesia's former strongman. He is also a new face, compared with Miss Megawati, Mr Wiranto—who was Mr Suharto's army chief—and the other two candidates, Hamzah Haz and Amien Rais, respectively the vice-president and the speaker of the upper house of parliament.

The front-runner comes from Java, the island where the majority of voters live (his running-mate, Jusuf Kalla, comes from Sulawesi, one of the outer islands). Women, it is said, admire his looks. And his opponent's Golkar party has not recovered from the bitter contest to win its presidential nomination. Mr Wiranto's chief rival, Akbar Tandjung, is from North Sumatra, and would doubtless have got most of the votes there.

Miss Megawati's party, too, is disorganised and dejected after its drubbing in the parliamentary elections. Worse, in North Sumatra Miss Megawati disillusioned her followers by forcing the appointment of an unpopular provincial party chief. Support for Amien Rais, a former university lecture, has been climbing recently, but his educated, town-dwelling followers make up only a small fraction of the electorate.

Admittedly, Mr Susilo has not said much about what he will do once in office, but neither has any of the other candidates. He does not have a particularly glittering record to point to after a long career in the armed forces and several stints as a minister—but, again, neither does any of his rivals. Mr Wiranto, for

one, is accused of complicity in all manner of crimes, including the devastation of East Timor after it voted to secede from Indonesia in 1999, as well as the brutal repression of student demonstrations in Jakarta and the all-round kleptocracy of the Suharto regime.

Mr Susilo's Democrat Party is one of the smaller players in parliament, but any of the candidates would find it difficult to cobble together a coalition government. In other words, Mr Susilo is not so much the dream candidate as the best of a bad lot. The same goes for his singing.

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North Korea

Nuclear chess

Jul 1st 2004
From The Economist print edition

America makes a move

Get article background

SUDDENLY the pace of moves on the diplomatic chessboard has picked up. Last week, at the third round of six-country talks in Beijing to try to settle the North Korean nuclear issue, the United States, egged on by South Korea, Japan, China and Russia, set out its proposals for what North Korea would receive in return for the complete and speedy dismantling of its nuclear programmes. North Korea said it found “some common elements” but really “little new” in these. Nonetheless, there was much speculation that at this week's meeting in Jakarta of the ASEAN Regional Forum (ARF), an annual regional security dialogue, foreign ministers of the six would be huddling here and there in different combinations over next moves.

Two years ago, America's Colin Powell had a ground-breaking 15-minute chat at the ARF with his North Korean counterpart, Paek Nam-sun. But coffee talk was soon overtaken by the latest nuclear crisis. In October 2002, America presented North Korea with evidence that it was breaking a 1994 deal designed to end its nuclear moonlighting, using plutonium, by starting up a second, uranium-based route to a bomb. In the ensuing fracas, North Korea turfed out international inspectors and walked out of the Nuclear Non-Proliferation Treaty. Last year Mr Paek was “too busy” to show his face at the ARF. This year there is not only America's latest proposal to discuss, but also burgeoning ties with South Korea, progress in settling the cases of several Japanese citizens that North Korea abducted in the past, and rumoured trips in the offing by North Korea's leader, Kim Jong Il, to Russia and China.

But in the face-off between America and North Korea, all this activity does not bring the nuclear issue any closer to resolution. America still insists that North Korea dismantle all its nuclear programmes, the uranium one included. North Korea still denies publicly that it has a uranium programme (despite originally acknowledging privately that it had).

Last week America did drop the term “complete, verifiable and irreversible dismantlement”, which seems only to enrage North Korean officials. And it called for the North to give up its uranium “technology”, rather than its “programme”, in the hope that this would prompt the North Koreans to own up, especially since a Pakistani scientist, Abdul Qadeer Khan, has admitted selling them the necessary equipment.

If North Korea were to freeze all its nuclear activities, America says it would have no objection to the neighbours, particularly South Korea, providing needed oil and electricity; America itself would offer a provisional guarantee of no hostile intent. Then North Korea would have three months to account for its nuclear programmes and agree to their swift dismantlement before other benefits would flow.

North Korea is unlikely to agree to this when the six-party talks reconvene sometime before the end of September. It might eventually disarm, argues Gary Samore, a former negotiator with North Korea now at the International Institute for Strategic Studies, a think-tank, but only in stages that it could control. And it would probably seek to keep a nuclear hedge: if it gave up its uranium programme, it would want to keep the plutonium it has already produced in the country, under inspection, giving itself an option to build more bombs quickly (it is thought to have at least two already).

North Korea may be hoping for a deal more to its liking if John Kerry wins America's presidential election in November. Meanwhile, George Bush is in no rush either. He has scotched criticism from allies and Mr Kerry alike by showing that he is negotiating seriously. He has not yet sacrificed anything in the nuclear game with North Korea, and maybe gained a little.

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Pakistan

A blur follows a blur

Jul 1st 2004 | LAHORE
From The Economist print edition

The old, the new and the in-between prime ministers

Get article background

IT IS not exactly a sudden, dramatic change. On June 26th Zafarullah Jamali, Pakistan's prime minister for the past 19 months, was sent home by General Pervez Musharraf. He went without a whimper. Chaudhry Shujaat Hussain, the president of the ruling, pro-Musharraf Muslim League party, was duly given his job by parliament on June 30th. But it was also announced that Shaukat Aziz, the finance minister since 1999, is to be prime-minister-in-waiting for two months. Mr Aziz has to resign from the senate (from which prime ministers cannot be nominated) and then win a by-election to the national assembly before he can be voted in by the Muslim League as prime minister.

Mr Jamali's exit was expected. He had been appointed on the understanding that he would let General Musharraf rule Pakistan and Mr Hussain shepherd the Muslim League. People in the government had accused him of weakness, pointing to an upsurge in political violence in the country. The assassination of political leaders in Lahore and Karachi has sharpened the fear of terrorism. There has been no easing of religious sectarianism.

But it was when Mr Jamali began to deviate from his assigned role that it became clear his days were numbered. Last year he failed to help General Musharraf find a way through the legal and constitutional challenges raised by the opposition. He wavered when General Musharraf proposed a bill to enact a strong National Security Council. He lost Mr Hussain's confidence when he began to eye the secretaryship of the ruling Muslim League. And he infuriated his military boss when he declared publicly that General Musharraf would resign as army chief before the end of the year, despite the general's statement that the issue was far from settled.

AP

The new and future new prime ministers

Mr Aziz, to be sure, has demonstrated no such tendencies. A former banker with no real political constituency in Pakistan, he has billed himself as the “technocrat-architect” of Pakistan's economic turnaround—from 2.5% GDP growth five years ago to about 6% this year.

But the opposition Muttahida Majlis-i-Amal (MMA)—a six-party religious alliance which supplies the leader of the opposition in parliament and rules two of Pakistan's four provinces—has denounced the urbane and westernised Mr Aziz as “an American agent come to wean Pakistan away from its Islamic moorings”. The MMA is expected to join hands with the parties of two former prime ministers, Nawaz Sharif and Benazir Bhutto, and put up a strong joint candidate to contest the assembly seat which Mr Aziz needs if he is to become prime minister. There is muttering, too, among the Muslim League's rank and file about the fact that General Musharraf failed to choose a prime minister from among the party's representatives already in the national assembly.

No swift change in the country's foreign and economic policies is expected, since decision-making will remain in General Musharraf's hands. While prime ministers were being waltzed in and out, the Indian and Pakistani foreign ministers met in Delhi for two days of bilateral talks focusing on Kashmir, and a new round of discussions is scheduled for August.

Mr Jamali's sudden departure and Mr Aziz's imminent arrival will be greeted with a wry smile by those

who criticise the way that Pakistan has been run under General Musharraf. Indeed, some people are questioning whether the general really will take off his army chief's uniform at the end of the year, as promised. Quite a few suspect that he will find a way to amend the constitution and fashion a presidential system more to his liking than the hybrid one Pakistan has today.

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Israel and Palestine

Talking again (but not to each other)

Jul 1st 2004 | TEL AVIV
From The Economist print edition

Reuters

Israel's proposal to quit the Gaza strip may with luck, despite the continuing violence, lead all the parties back to negotiation

Get article background

WILL he? Won't he? Opinion in Israel is divided over whether the prime minister, Ariel Sharon, is still determined to get rid of the Gaza strip, which, along with the bigger and more populous West Bank, has been under Israeli occupation since the Arab-Israeli war of 1967. The latest signs are that he may once more push ahead with his plan to leave Gaza, while seeking to consolidate Israel's hold on a bigger swathe of the West Bank than Palestinians are wont to accept in an overall peace package.

The American administration, along with the other three members of the “quartet” of involved outsiders—the UN, the European Union and Russia—seems keen to clinch the Gaza withdrawal first, then move on later to negotiations over the West Bank. No less hopefully, the Egyptians, whose border abuts Gaza, seem to be going along with that idea too. The Jordanians warily approve.

Since the rejection two months ago of Mr Sharon's original withdrawal plan in a referendum of his own Likud party, along with threats by two other parties in his four-party coalition to quit the government if he went ahead with the plan, leaving him with a minority of seats in parliament, the prime minister came up with a watered-down version. Under the new scheme, the Israelis would leave the strip—albeit under tighter conditions.

Such revived hopes could still be dashed if the violence gets out of hand. On June 26th, Israeli troops killed seven Palestinians in Nablus, the West Bank's biggest town, including the heads of the three main guerrilla groups in the city, including one that is linked to Yasser Arafat's Fatah party. Next day, the fundamentalists of Hamas blew up an Israeli military outpost on the edge of Gaza. A day later, a rocket fired by Palestinians from Gaza killed two Israelis in the border town of Sderot. When Mr Sharon, who has a ranch nearby, visited the town the next day, a rocket landed a few hundred metres away.

Israel responded by invading the northern area of the strip from which such missiles are fired, and made it clear that reprisals and incursions could continue before, during and after a withdrawal (see article). Mr

Sharon would find it harder to withdraw if his forces were seen to be leaving with their tails between their legs, as when they abandoned southern Lebanon four years ago. His opponents, both in Likud and in parties further to the right, are already denouncing the idea of withdrawal as a “reward for terrorism”.

Egypt, wary of Gaza becoming a hotbed of Muslim fundamentalism, is playing a significant part in the diplomacy. Mr Sharon wants its government to take partial responsibility for security in the strip, once the Israelis have left, and to help seal the border against arms smugglers. Indeed, though Mr Sharon is officially wedded to the idea of a Palestinian state, he would like the Egyptians to have a degree of control over the Palestinians in Gaza, just as he may still hope for similar Jordanian co-operation in the West Bank.

Though Egypt's president, Hosni Mubarak, has yet to meet Mr Sharon, the two leaders have been talking by telephone and their senior officials have exchanged visits. Mr Mubarak has presented a set of demands both to Mr Sharon and to Mr Arafat, who still heads the ailing Palestinian Authority. The Egyptians have asked Mr Arafat to hand his portfolio for Palestinian security to someone else, while they want Israel to promise to get out of Gaza altogether and not come back.

Arafat is still there

The argument in Israel over the disengagement plan has revived the debate, even within Likud, over the acceptability of a Palestinian state. The Israeli government and the Americans say Mr Arafat is no longer a worthwhile negotiating partner. But the UN, the Europeans and, for that matter, Israel's Labour opposition leader, Shimon Peres, do not agree. All of them have long been exasperated by Mr Arafat's poor leadership, but argue that he still has the authority to block Palestinian moves back to a negotiating table.

It is still possible that Mr Sharon and his government, divided by internal differences over the Gaza plan, could fall—perhaps over a budget resolution, due by November. Palestinian and Arab opinion is divided too. Some see the Gaza idea as an opportunity, others as a threat that would allow Mr Sharon to consolidate his hold on extra pieces of the West Bank. A number of prominent Palestinians in Fatah may spot their chance to succeed Mr Arafat. But at least the diplomacy is no longer frozen.

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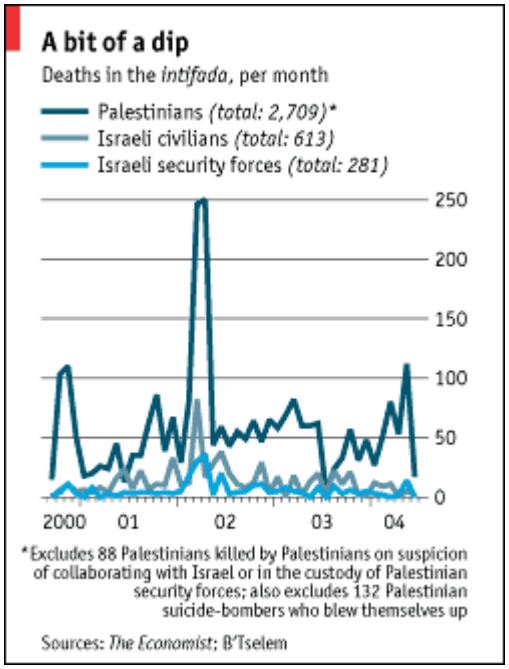
Israel and Palestine

Who's winning the fight?

Jul 1st 2004 | TEL AVIV
From The Economist print edition

Fewer suicide-bombers have been getting through but some are still bound to

Get article background



ONLY a week ago, Israel's defence minister, Shaul Mofaz, implied that the Palestinian fighters were being contained if not defeated. He said that suicide-bombings, the Palestinians' most devastating and demoralising weapon, had fallen in number from 60-plus in the first half of 2002 to 17 in the first half of 2003 and six so far this year, with none since mid-March. And the Israelis say that 29 suicide-bombers were nabbed in the West Bank in May and June before they could kill themselves—and their would-be Israeli victims.

Israeli officials say that several factors have helped. One is the not-yet-complete barrier that the Israelis have been building to stop Palestinians entering Israel from the West Bank; it cuts deep into Palestinian territory in order to protect Jewish settlements there and is fencing Palestinians into shrinking enclaves in which a Palestinian state would suffocate. (This week, Israel's Supreme Court said that the route that cuts through an Arab area north-west of Jerusalem should be changed, and on July 9th the International Court of Justice at The Hague may declare the barrier illegal.)

Another reason cited by Israelis for the reduction in the number of suicide-bombs is their assassination of Palestinian leaders, especially those of Hamas, thus keeping their commanders on the run and disrupting operations. Yet the apparent interception of those 29 suicide-bombers suggests that there is no shortage of potential recruits.

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Iraq

What sort of handover?

Jul 1st 2004 | BAGHDAD
From The Economist print edition

Iraq's new prime minister, Iyad Allawi, tiptoes into office, then bangs the table

Get article background

WHAT an anti-climax. After a seven-month build-up, Iraq assumed its sovereignty like a bride at a secret shotgun marriage in a bare registry office. There was hardly a celebration, let alone a galaxy of guests. After signing a document, Paul Bremer, the American diplomat who had ruled as a proconsul for just over a year, scurried home almost without a goodbye.

A grand ceremony might have conveyed the impression that America was handing over to a bunch of puppets. The new interim government under Iyad Allawi is plainly very keen to scotch such an idea. In his first cabinet meeting, he scrapped Mr Bremer's suspension of the death penalty, declared a general amnesty for violent crimes against the outgoing administration (provided that penitents hand in weapons and leak information) and proposed to revoke Mr Bremer's first decree, which barred all senior Baathists from office. To symbolise the transfer of authority, Saddam Hussein was arraigned before an Iraqi court. In sum, Mr Allawi signalled that he meant business.

Since he took over, Iraq's security and police forces may already have perked up. They have launched dozens of raids, mainly in Baghdad. Human-rights campaigners think the police may have begun to throw their weight about too much. Mr Allawi may, say liberals, call an early cabinet reshuffle to get rid of their kindred spirits, such as Mehdi Hafez, the planning minister. The UN Security Council's resolution gives the incoming government only seven months before a general election is held. But Mr Allawi is behaving not at all like a caretaker.

This seems to please a lot of Iraqis, especially if they think their compatriots will now run the country's finances. A recent report by the General Accounting Office in Washington accuses the outgoing administration in Iraq of handling Iraq's revenues sloppily. It had apparently spent only $3 billion of the $24 billion of American money that was to have been available for reconstruction in the first year since Mr Hussein's downfall, yet had disbursed some $8.3 billion of the $21 billion in Iraq's own coffers.

But it will not be easy for Mr Allawi to convince Iraqis that he is in charge. Although government buildings are now adorned with Iraqi flags, they are still screened off from the public gaze behind the fortified walls surrounding Baghdad's “international zone” (still popularly known as the “green zone”), where the American-led coalition had its headquarters. The Coalition Provisional Authority is no more, and all but 200 of its staff of 3,000 have left. But, within hours of Mr Bremer's departure, America's new ambassador, John Negroponte, had taken command of a staff of 1,000 Americans, aided by 700 others, in a huge new embassy in the same zone.

More visibly, America's tanks still roll through the streets. Its military prosecutors can still overrule Iraqi judges—and re-arrest prisoners acquitted in Iraqi courts if they are deemed a security risk. On the first day of full sovereignty, American soldiers stormed the interior ministry's guest-house after a report that Iraqi interrogators there had been torturing pimps and drug-peddlers picked up in a swoop. The Americans briefly arrested eight Iraqi policemen.

Iraqis angered by the revelations in May of abuses of prisoners by American soldiers at Abu Ghraib are not quickly going to be re-persuaded that Americans are their friends. In a letter to a foreign-policy institute in Philadelphia, an American civil administrator accuses the American armed forces of actions “condoned by the chain of command” which include “shooting at Iraqi vehicles on major highways, destroying walls that have anti-American graffiti painted on them, collectively detaining all males in a given area or village for up to several weeks or months, and detaining pre-adolescent family members of

suspects in an effort to force suspects to turn themselves in". If true, that is hardly the way to win hearts and minds.

But some signs are pointing the other way. Mr Allawi knows his first task is to fend off the insurgents. He has reached out to the rebellious Baathist rump and offered an amnesty to Iraqis captured after attacking coalition forces (though they are still in American custody). It is early days, but there is evidence that his approach is working. A predicted wave of car-bombings in Baghdad on June 30th did not materialise. Several anti-American movements, including Sunni clerics and Shia ones such as the firebrand Muqtada al-Sadr, as well as more secular groups with Baathist leanings such as al-Islah, are cautiously backing Mr Allawi and denouncing Iraqis using violence against fellow Iraqis.

But this degree of reconciliation among Iraqis has not reduced the rate of attacks, still running at about 50 a day, on American forces. And as re-Baathification proceeds, Mr Allawi's fledgling security forces may soon embrace more men who served under Mr Hussein than those who did not. Who knows where their loyalties will lie?

Mr Allawi hopes that the airing in court of the atrocities committed by Mr Hussein will finally bury any temptation to feel nostalgia for him. In interviews on Arab satellite television, he has described his own past Baathism as driven by nationalism. Mr Hussein, he says, was different: a gangster leading a "handful of deviants" within a once respectable movement. But Mr Hussein's trial carries the risk of reopening old wounds—between Kurds and Arabs, between Sunnis and Shias, between the Iraqis who worked for him and those he oppressed. It is still too early to know whether a new day has dawned.

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Sudan

The calamity continues

Jul 1st 2004 | KHARTOUM
From The Economist print edition

Colin Powell and Kofi Annan try to ease the catastrophe in Darfur

Get article background

EPA

No food, and no home to return to

LOOKING over the calm waters of the Nile from a Khartoum café, you would not think you were in a country scourged by civil war. Seeing Arabs and black Africans rub along amicably in the city's markets, you would not think that Sudan was the scene of horrific ethnic cleansing. But it is, which is why Colin Powell, America's secretary of state, and Kofi Annan, the UN's secretary-general, paid a visit this week to try to get the Sudanese government to behave less dreadfully.

Its actions in Darfur, a western region, have created arguably the worst humanitarian crisis in the world today. The Arab-dominated regime in Khartoum is fighting a revolt there by discontented blacks, and has been driving black Darfuris from the smoking remains of their homes. Most of the driving is done by a mounted militia called the *janjaweed*, which the government arms but pretends not to.

Some 1.2m blacks have so far fled this campaign of burning, looting and murder. American aerial photos show 576 villages in Darfur, of which 300 have been completely destroyed and 76 substantially so. Female refugees report being triumphantly told, as they were being gang-raped, that they would bear Arab babies. Having lost everything, Darfur's fugitives face hunger and disease. Andrew Natsios of USAID predicted this week that 1m might die if help did not come fast.

Despite stringent censorship, news of the carnage in Darfur has filtered out. A few Sudanese have satellite dishes, and rumours spread fast. The government's claim to have the situation under control was widely dismissed even before Mr Powell and Mr Annan showed up.

Without once unfurrowing his brow, Mr Powell told a press conference that, if Khartoum did not move to make Darfur safer for civilians and aid workers, the UN Security Council would take action “within days or weeks”. A leaked draft resolution called for an arms embargo and travel ban on *janjaweed* leaders, with an implied threat of broader sanctions if matters do not improve. Sudan's foreign minister promised to co-operate.

The regime is feeling hemmed in. In recent years, American pressure has required it to make much-resented concessions in pursuit of peace with a different set of rebels in the south. Since last year, military successes by rebels in Darfur have made it fear that it may be losing control.

The regime has no democratic legitimacy, and harbours doubts about the loyalty of its armed forces. Some servicemen are so repelled by what they have been made to do in Darfur that they are finding ways to avoid obeying orders. One air force officer complains that he was told he would be bombing rebels, but instead saw women running out of the huts he had attacked with their robes ablaze. “I couldn't do it any more,” he says. Opposition groups are protesting as loudly as Sudan's oppressive laws permit. Hassan al-Turabi, an Islamist leader under house arrest, began a hunger strike this week, along with 66 of his followers.

Last week, President Omar al-Bashir claimed that conditions in camps for displaced Darfuris were better than in nearby villages. That may be true. Although the camps are damp, sordid, disease-ridden and

scandalously short of food, people stay there for fear that, if they go home, they will be murdered by the *janjaweed*.

Does the situation qualify as genocide? Mr Powell was vague. “We see indicators and elements that would start to move you towards a genocidal conclusion, but we're not there yet,” he said on June 29th.

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South Africa's economy

Tack to the left

Jul 1st 2004 | JOHANNESBURG
From The Economist print edition

President Thabo Mbeki tires of market liberalism

THABO MBEKI, South Africa's president, has long been fond of leftish rhetoric. For a long time he was a member of the Communist Party. Since attaining power, he has governed in a reasonably market-friendly manner. But he has recently started to veer back to the left, in word if not yet in deed. Last week, for example, he attacked those who “celebrate individualism and denigrate the state”. Then he backed his land minister, who wants to consider barring foreigners from owning land in South Africa. Peter Bruce, who edits *Business Day*, a newspaper, says Mr Mbeki is “itching to break free from the conventions of textbook capitalism”.

No change is expected to his much-applauded macroeconomic policies, which emphasise low inflation, growth, stability and the expansion of trade (though he does promise more deficit spending). But there is already a discernible move leftward in some microeconomic policies: a new law controlling medicine prices is in force; plans to privatise big state firms have been dropped, and the government is intervening more in business, for example by demanding the faster transfer of shares to black investors. “Together it is a qualitative change,” concludes one analyst.

If so, why? One answer is that Mr Mbeki is frustrated that South Africa's economy is plodding along too slowly to create jobs for the poor. A central-bank study published this week records that there were 5.1m proper non-farm jobs in 1980, but only 4.7m in 2001, even though the population has grown by nearly two-thirds, to 45m. The report argues that unemployment has been high for so long that it cannot be cured by growth alone.

Mr Mbeki's solution is more state intervention. Ideas mooted include public works, new money for training and perhaps even subsidies for firms that hire. His advisers think this will boost growth, which will attract long-term investors.

The president has another, political, motive. Two years ago he fought trade unionists and communists, who are formally allied with the ruling party, the African National Congress, when they threatened to strike against privatisation. He beat them down, but he fears they may bounce back. Swinging to the left a bit may placate them, which could bolster this chess-loving president's position as the ruling party searches for his successor, who is due to be anointed in 2007.

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The European Commission presidency

A Lisbon agenda

Jul 1st 2004 | BRUSSELS AND LISBON
From The Economist print edition

AP

José Manuel Durão Barroso, the next European Commission boss, will have to fight hard for a liberal economic agenda in Brussels

UNTIL last week, few people outside Portugal had heard of the country's prime minister, José Manuel Durão Barroso. But the man chosen to be the next European Commission president has been immersed since his teens in politics. In the 1970s he was a Maoist activist, daubing caricatures of capitalists on walls and preaching the dictatorship of the proletariat. As he explained in Brussels this week, at Lisbon University during the Portuguese revolution there were only two political parties: pro-Soviet Communists and pro-Chinese Communists. The Maoists were the more forward-looking.

Today Mr Barroso is the very model of a modern prime minister. As a centre-right leader he has been unpopular with the proletariat for his budget cuts and privatisations. He is well-placed to thrive in Brussels. He speaks English, French and Spanish fluently. He is only 48, yet has a wealth of international experience, including negotiating a peace deal in Angola.

Mr Barroso sees his new role as that of honest broker and “point of equilibrium” between conflicting groups. He does not want to build up the prestige of the commission against national governments. That is a change from some ambitious predecessors, who saw the commission as a European government in embryo. Yet, as Mr Barroso notes, the role of honest broker will be trickier in an enlarged European Union. “The risks of polarisation will be much greater with 25 member states,” he says. “We have to avoid any fragmentation between founding states and newcomers, between the centre and the periphery or between the rich and the poor. The key issue is fairness.”

It is inevitable, he adds, that different countries will move towards further integration at different speeds. But this should not lead to some being treated as second-class members. “There can be no directorate of countries saying these are the member states that can move forward, while the others are left in the waiting-room,” he declares. Such words will be a relief to the smaller countries which fear that France, Germany and Britain have precisely such a directorate in mind.

Mr Barroso faces an early test of his ability to stand up to France and Germany. In return for backing him, the French and Germans have made clear that they expect big economic portfolios in the next commission. The Germans want the job of a new “super-commissioner” for the economy; the French have their eye on the competition post. Big EU countries, which have just lost their second

commissioners, naturally want top jobs in Brussels. This week France won the reappointment of Pierre de Boissieu as boss of the Council secretariat, and Spain the renomination of Javier Solana as foreign-policy supremo.

But the worry in the commission is that the French and Germans want these jobs to promote illiberal economic ideas. Gerhard Schröder, the German chancellor, has talked of the need to protect manufacturing industry. The French see Mario Monti, the current competition commissioner, as an ultra-liberal: he has crossed swords with Paris several times. Liberals are alarmed. Frits Bolkestein, the single-market commissioner (a post that Britain covets), has said that Franco-German calls for a return of industrial policy made him feel he was living in a 1970s time-warp.

Mr Barroso's sympathies are with the liberals, as his record shows. But there are suspicions that he may already have given undertakings to France and Germany to secure their support. In a press conference this week, Mr Barroso insisted that no decisions had been taken and emphasised his right to deploy his team as he sees fit. But no new commission president will relish starting in a showdown with France and Germany. Managing this tension will be Mr Barroso's first and most crucial task.

The potential for tension between Mr Barroso and the Franco-German pair is heightened by his support for the Iraq war. It was as foreign minister in the 1990s that Mr Barroso staked out his position as an Atlanticist, arguing that Portugal was bound by geography and history to maintain strong links with Britain and the United States. He hosted a pre-war summit with America's George Bush, Britain's Tony Blair and Spain's José María Aznar in the Azores. Indeed some thought the Azores summit would make him unacceptable to France and Germany.

The French were swayed by his fluency in their language. And Portugal has sent only 120 policemen to serve in Iraq. Even so, the British are surprised that France did not veto Mr Barroso. One senior British politician unwisely proclaimed the decline of French influence in the EU—ensuring that the new president will be keen to show his independence not just of France and Germany, but of Britain too.

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NATO summit

Those who can't fight, train

Jul 1st 2004 | ISTANBUL
From The Economist print edition

Some satisfaction for the Americans

AFTER two days when he was besieged by stone-slinging pacifists, stung by Gallic slurs and heard more bad news from Iraq and Afghanistan, George Bush left the NATO summit in Istanbul this week with a minimal offer of support from his country's oldest allies. Nonetheless, the Americans went home relatively pleased with what they had managed to achieve.

Most pleasing was an undertaking by NATO to train an Iraqi army. The alliance was answering a plea from Iyad Allawi, Iraq's new leader, backed by a surprise visit to Istanbul by his foreign minister. This was a triumph of diplomacy for the Americans who were, after all, in charge of Iraq when Mr Allawi made his request. But, at least initially, NATO'S commitment will be modest.

France and Germany agreed to the plan on the basis that they would only train Iraqis outside the country. But a suggestion by France's Jacques Chirac that no troops would operate in Iraq under a NATO flag is poppycock. Building on the work of the 16 NATO members with troops in Iraq, and on the recent UN Security Council resolution, NATO will lend to America's salvage efforts a moral support that was unthinkable before. NATO's leaders also vowed to consider “further ways to support the nascent Iraqi security institutions”. This will have sounded far sweeter to Mr Bush than the distant clamour of anti-war protests.

Yet NATO has a record of raising false hopes, as Hamid Karzai, Afghanistan's leader, knows well. Mr Karzai came to Istanbul to beg NATO to keep its word to his broken country. Ten months after the alliance took over a peacekeeping mission in Afghanistan, it has posted only one garrison outside Kabul. In Istanbul, it announced a small increase to its 6,500-strong, mostly European force. With around 1,500 more troops, probably from Spain and Italy, NATO plans to plant three more garrisons in northern Afghanistan, where it will also take over two small garrisons now run by an American-led army that is fighting the Taliban.

Another 3,000 troops will be committed to protect elections due in September, though half will stay on standby in Europe. This seems odd, since the elections are threatened more by small-scale violence and coercion than by big battles. The past week has offered examples, such as the slaughter of 16 peasants after the Taliban found them carrying voter registration cards. Standing alongside Mr Karzai in Istanbul, Britain's Tony Blair insisted that Afghanistan remained the alliance's priority. Considering NATO's performance there, that does not bode well for Iraq.

Of 1.5m regular soldiers available to NATO's European members, fewer than 100,000 can actually be deployed. Over-sized and underused, most NATO armies were designed to hold off Soviet tanks until America could unleash nukes. Since the cold war ended, there has been much talk of transformation, but little action, as defence budgets have shrunk. This has left European armies largely incapable of the special-forces operations and distant peacekeeping missions that are now in demand. In Istanbul NATO's defence ministers vowed to make 40% of their forces deployable and 8% instantly deployable, a mark that only a handful can now meet.

In another effort to get members to honour their commitments, NATO is to review how it raises troops for its missions. Insiders want a predictive process that allows countries to plan troop contributions for NATO missions several years ahead, and to adjust defence budgets accordingly. Ideas like these are valueless unless European governments are willing to spend more, and more wisely, on defence. Yet that they, and a dozen other joint initiatives, are being developed suggests that NATO may be doing some things right.

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Prostitutes in south-east Turkey

A sad legacy

Jul 1st 2004 | DIYARBAKIR
From The Economist print edition

One regrettable aftermath of Turkey's Kurdish rebellion

IN A pastry shop in Diyarbakir's Baglar neighbourhood, garishly painted women bat their eyelashes through plumes of cigarette smoke. One looks barely 16, yet bargains for sexual favours like a hardened madame. The scene is familiar in Turkey's mainly Kurdish south-east—and what troubles Kurds is that some of the girls are from their own community. In the puritanically devout south-east, chastity is a girl's chief asset, and a matter of honour for the clan. A woman who stains the family name through extra-marital sex may even be killed by her father or brothers.

In Diyarbakir, the world's oldest profession was limited until recently to one officially sanctioned bordello, a white concrete building just outside the city. None of the women in it are Kurdish. Indeed, the word prostitute does not exist in any Kurdish dialect. But, as Ahmet Sumbul, author of a book on prostitution in the south-east, comments, “Kurdish girls are now being peddled—often with the collusion of state officials.” Mr Sumbul has faced death threats and a smear campaign, with some newspapers accusing him of abetting the outlawed Kurdistan Workers Party (PKK), now renamed the Kongra-Gel group.

Hasim Hasimi, a Kurdish politician, says the phenomenon described by Mr Sumbul results from the 15-year separatist war that was called off by the PKK after the capture of its leader, Abdullah Ocalan, in 1999. Seeking to cut off support for the rebels, the Turks expelled at least a million Kurds from their villages. Many ended up in shanty towns around big cities with no means of support, so they turned to crime, drugs and prostitution. In remote Kurdish provinces such as Sirnak and Hakkari, local Turkish officials sanctioned pornographic television broadcasts, says Mr Hashimi, who was then a local mayor. “There was an effort to unravel our society's moral fabric, and this is the result.”

The rebels have threatened to resume fighting unless there is a full amnesty for their captured fellows. To score points with the European Union, Turkish television recently began its first-ever broadcasts in Kurdish, and a court has released Leyla Zana, a Kurdish politician—but an amnesty for the rebels is unlikely. And the call-girls? Firat Anli, mayor of Diyarbakir's Yenisehir district, says he has launched several projects to educate women and create jobs for them, but he admits it is an uphill struggle. There is, though, some good news. Prompted by Mr Sumbul's book, the Diyarbakir police recently freed several young sex slaves.

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Europe and Iran

A common flop

Jul 1st 2004
From The Economist print edition

The Europeans' soft approach to Iran seems to have failed

Get article background

IT WAS worth a try. But hope is fading in Britain, France and Germany that engagement with Iran might succeed, where America's cold shoulder failed, in coaxing the regime in Tehran into giving up the nuclear experiments and technologies that it has spent 18 years hiding from the world.

Last October, the three European countries were cock-a-hoop over a deal to get Iran to come clean about its nuclear dabblings to inspectors from the International Atomic Energy Agency (IAEA), and to suspend its recently uncovered uranium-enrichment programme. In return, the European trio agreed to resist American pressure to report Iran's transgressions to the UN Security Council. Had “temporary” suspension turned permanent, ridding Iran of technologies that the government insists are for peaceful purposes but which can also make bomb material, the Europeans would have agreed to sell other technologies to the Iranians.

For the Europeans, the deal was the sweeter because it showed a new unity after the bitter divisions over Iraq, argues Steven Everts in a report for the Centre for European Reform, a think-tank. It bolstered the case for non-proliferation-by-inspection rather than force, and showed that multilateral diplomacy and “soft power” could work even on hard problems. And success would have shown that the European Union's common foreign policy (the full EU backed the big three) could make its weight felt beyond its own backyard.

So why has the diplomacy soured? Censured again last month by the IAEA‘s 35-country board for the gaps in its nuclear story, Iran last week wrote to the Europeans, accusing them of failing to keep their side of the October bargain. The Iranians now say they will restart the manufacture and testing of their uranium-enrichment machines at a pilot plant at Natanz.

Inspectors are still at work in Iran: this week they took samples at what the government admits is a military site (though not a nuclear one), called Lavizan, in Tehran, where recent satellite photographs showed that buildings had been demolished and topsoil carted away. They are due to report to the IAEA board in September. Iran insists its case should be dropped. That is unlikely to happen.

If Iran disrupts inspections or pulls out of the Nuclear Non-Proliferation Treaty (NPT), the Europeans would have to go to the UN. More likely, though, it will press on with its enrichment preparations, contrary to the IAEA's request and the October deal. Iran is also building a heavy-water reactor that could produce plutonium, another bomb ingredient. Neither technology is outlawed by the NPT, so long as it is for peaceful use. Despite having only a limited nuclear-energy programme, Iran claims an inalienable “right” to both. But past violations and unexplained traces of (potentially militarily useful) highly enriched uranium suggest that Iran is using the cover of electricity generation to acquire nuclear-weapons capability.

The premise of the October deal was that, offered a face-saving way to come clean and find a better relationship with the West, Iran would quietly drop any weapons ambitions. Although the premise appears to have been wrong, the Europeans have, so far, merely held up negotiations on a new trade and co-operation agreement. They have other levers at their disposal: some 40% of Iran's imports come from the EU which, with Japan, is also Iran's best hope for badly needed investment in its oil and gas industries.

Iran and the Europeans seem now to be playing for time, awaiting the outcome of November's

presidential election in America. But whoever wins, America is unlikely to tolerate a nuclear-arming Iran. Some Europeans hope that a new administration might try talking to Iran. But, with America tied up in Iraq, the Iranians may calculate that time is on their side and—so long as the IAEA finds nothing new—that the Europeans will never agree among themselves to a tougher line. If so, far from being a success for Europe's common foreign policy, Iran could become a big irritant in relations between America and Europe.

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The French Socialist Party

Sauce Hollandaise

Jul 1st 2004 | PARIS
From The Economist print edition

A reinvigorated party is still in search of a forceful leader

Get article background

SIX months ago, party hacks were urging François Hollande, the French Socialist leader, to roll up his sleeves and impose himself more. He resisted, preferring a low-profile, collegial style. Today, this approach seems to have paid off. Fresh from two electoral victories, at regional and European elections, Mr Hollande has, improbably, become what the French call *presidentiable*. With a photogenic partner, Ségolène Royal, also fresh from a regional election win, could he turn an unexpected triumph into a lasting swing to the left?

Two years ago, the Socialists were in shock after the eviction of Lionel Jospin in the first round of the 2002 presidential election by the National Front leader, Jean-Marie Le Pen. Mr Hollande was seen as a caretaker, with no chances of his own in the 2007 presidential election. He was doomed, as a colleague put it, by "his absolute lack of charisma". Like Britain's Labour Party after 1979, the Socialists faced the rise of the hard left outside the party, and a rejection of centrists such as Laurent Fabius and Dominique Strauss-Kahn within. Officials talked of a structural shift to the political extremes.

Today, Mr Hollande has a spring in his step, and party headquarters hums with new energy. For the first time in two years, it believes it can win in 2007, and Mr Hollande is preparing the ground. In September, a policy commission starts work on a manifesto. In early 2006, party members will elect a presidential candidate. Despite his low personal popularity (see chart), "Hollande is now considered a serious contender," says one insider.

Mr Hollande has other assets. His long-term partner, Ms Royal, delivered a snub to Jean-Pierre Raffarin, the prime minister, by winning the presidency of his region, Poitou-Charentes. Though affable and humorous in private, Mr Hollande has an insipid public image. But Ms Royal's victory has fleshed him out; together they make a power couple. Nor should Mr Hollande's low popularity be taken for granted. He may be a classic urbane technocrat: he and Ms Royal were fellow students at the Ecole Nationale d'Administration. Yet he is a member of parliament for rural Corrèze, President Jacques Chirac's heartland, and mayor of a town there, so he may be more attuned to the grass-roots than he seems.

The Socialists' recent electoral success came largely by default, however. Mr Hollande persuaded the electorate to vote tactically, robbing the hard left of support, and he kept the left broadly united. But his campaign message was negative: essentially, kick the government in the teeth. "It isn't enough just to wait till 2007," he concedes. "We must lead a campaign for our ideas." But what ideas? Mr Hollande's insistence on collegiality is a recipe for blandness. The manifesto process is not designed to foster bold thinking or leadership; the candidate must adopt it wholesale. This means policies tilted to the left.

Mr Hollande defends the 35-hour week. He is unapologetic about the manifesto. "The Socialist Party is a co-operative, it cannot impose a programme," he says. The process, he adds, is designed to stop personal rivalries dividing the party. But consensus-seeking annoys some. "He's indecisive, wants to please everyone," comments one adviser. He is pro-European, but has not decided whether to back the new EU constitution, which many Socialists consider too free-market. Tellingly, he has never had a

ministerial job.

Who else might unite the party? Candidates abound. The two heavyweights, Mr Fabius and Mr Strauss-Kahn, are among the least popular, though both have strong rival camps in the party. The most popular—Bernard Kouchner, Jack Lang and Bertrand Delanoë—have a less firm grip on the party, though Mr Delanoë is a well-liked mayor of Paris. Martine Aubry, architect of the 35-hour week and mayor of Lille, has been quiet, but could try a come-back. So might Mr Jospin, whose recent visibility belies claims to be in retirement.

There is, though, another possibility closer to home: Ms Royal. She has the popularity and forcefulness that her partner lacks. Could Mr Hollande persuade the party that its best chances lie with his other half?

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The Czech Republic

One more defenestration

Jul 1st 2004 | PRAGUE
From The Economist print edition

Vladimir Spidla quits as prime minister

JUST 15 years after the Velvet Revolution, the Czech Communist Party has found a new way to threaten democracy: by getting dangerously popular. In the European elections last month the Communists finished second, with 20% of the vote, more than twice the score of the ruling Social Democrats, who came fifth. That lamentable performance provoked the resignation this week of the prime minister, Vladimir Spidla, and his government.

Other Czech parties scorn the Communists as “undemocratic”, and refuse to do business with them. But the more votes the Communists win, the more undemocratic this cartel against them starts to look. President Vaclav Klaus has insisted on shutting them out of talks to form a new government, even though they hold one-fifth of the seats in parliament. How much of the vote would they need to be included? “51%”, retorts an aide to Mr Klaus.

This shunning is understandable. The Czech Communist Party, unlike many siblings in other countries, has not renounced its past, its Marxist ideology, or its name. Its 100,000 members are nostalgic for the days when they ruled by force, and suspicious of their country's ties with the West. They want the Czech Republic out of NATO, which it joined in 1999, and are in two minds about the European Union, which it joined this year.

In many ways, pariah status suits the Communists. They can pile up the criticism and the protest votes without having to produce workable policies of their own. But the system pays for their free ride. A chunk of the national vote is thrown away. The need to work round them leads other parties into improbable and unsustainable alliances, such as the coalition that failed this week. After the 2002 general election, the Social Democrats and Communists could together have formed a strong left-wing majority in parliament. Instead, the Social Democrats cooked up a coalition with small centre-right and right-wing parties. This ill-made soufflé has now collapsed halfway through its term. Months will be wasted in attempts to form a new coalition, perhaps from the very same parties. The attempts may well fail, forcing an early election; even if they succeed, the new government may not last.

The Czech Republic needs to find a way out of this frozen conflict with its Communists. One answer might be the emergence of a Social Democrat leader with the political genius to lure the Communists into an alliance and then to humiliate them, as François Mitterrand did to the French Communists in 1981. The new party boss, Stanislav Gross, 34, may be too green for this. Colleagues say he will continue the boycott for fear of going down in history as the man who let the Communists back. Better by far if he became known as the man who punctured their bubble.

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Italy's troubled prime minister

On the ropes

Jul 1st 2004 | ROME
From The Economist print edition

Silvio Berlusconi is cornered by his coalition allies

Get article background

LIKE a boxer, Silvio Berlusconi weathered the first punch, but then came the uppercut. On June 13th, his Forza Italia party lost a sixth of its voters in the European elections. Two weeks later, voters in Milan delivered a dizzying second blow. Italy's financial capital and Mr Berlusconi's birthplace, Milan is also where he nurtured his political project. The left's candidate, ex-mayor of a town once known as Italy's Stalingrad, could scarcely be more typical of the *ex-communisti* Mr Berlusconi uses as bogeymen to scare the middle classes. Yet Milan's provincial governor lost more decisively than expected. Support for Forza Italia crumbled even in rich areas.

But is the prime minister staggering towards the canvas? One centre-left senator, Nando dalla Chiesa, proclaims “the end of Berlusconi”. Italians tend to overreact; but they can also recognise trends early. And what Milan thinks today is often what the rest of Italy thinks tomorrow, as the “wind from the north” periodically rearranges Italy's political landscape.

There are other reasons for believing a corner has been turned. The two votes have weakened Mr Berlusconi personally, and that could prove fatal for his coalition, a motley assortment of former neo-fascists (in the National Alliance), Christian Democrats (the Union of Centre Democrats, or UDC) and regional populists (in the Northern League). These parties want very different things. The National Alliance and the UDC are demanding a greater say in policymaking. They could thus stop Mr Berlusconi pursuing the policies needed to win back his supporters.

The National Alliance and the UDC draw most votes from the poorer south and centre, often from the public sector. Already, they have taken aim at tax cuts promised by Mr Berlusconi. The National Alliance says it will back them only if they are first made available to poorer taxpayers, which is anathema to liberals in Forza Italia. The National Alliance and UDC also dislike the government's proposed constitutional reform to make Italy more federal. But Northern Leaguers counter that, if constitutional reform goes, so will they.

As Mr Berlusconi threw himself into a round of meetings intended to produce a cabinet reshuffle and a rejigged government programme, he vowed not to let a mid-term setback bring him down. But he and his partners could yet squabble their way to destruction.

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Charlemagne

What price euphoria?

Jul 1st 2004
From The Economist print edition

Lessons from small countries that stage big sporting events

IN MEDIEVAL Europe rulers who wanted to make a statement built a cathedral. In modern Europe they build sports stadiums. This weekend the eyes of much of the continent will focus on the Stadium of Light in Lisbon, where the final of the Euro 2004 football championships will be held. Combine the soaring architecture, the songs, the dazzling lights and the delirious fans, and the final may even feel a bit like a religious ceremony. In August it will be Athens's turn to take the spotlight, when it hosts the Olympic Games. A frantic race to complete all the Olympic facilities is now under way.

For Portugal and Greece, Euro 2004 and the Olympics serve similar purposes. They are international coming-out parties for small countries that fret about being on the geographic, political and economic fringes of Europe. Both countries moved from dictatorship to democracy in the 1970s. Both had their fitness to host big sports events questioned, because of their small populations (around 10m apiece) and relative poverty; Portugal and Greece were long the poorest of the EU's 15 countries. Both see this summer's sporting events as a chance to make a statement. The press handbook for Euro 2004 contains a potted history of Portugal featuring revolution, dictatorship and loss of empire, before noting, a touch defensively, that “Portugal is now a modern and progressive nation.” Certainly anyone ambling past the bars and restaurants of Lisbon, packed with football fans, would find it hard to believe that 30 years ago this was a city choked with refugees, as a million settlers flooded back into Portugal after the liquidation of its colonial empire.

Yet using a sports tournament to make a statement about your country is neither risk- nor cost-free. The Greeks fear that construction delays and cost overruns may reinforce the idea that their country is not quite first-world, rather than scotch it. The Portuguese did better, building or completely refurbishing ten football stadiums in plenty of time for the tournament. Even so, it seems a bit extravagant to blow €660m on new stadiums for a four-week tournament in a country that is just emerging from its deepest recession in three decades.

The Portuguese bid to host Euro 2004 was made in the middle of a long economic boom. But by the time the tournament was actually on the horizon, the country was suffering from a severe economic hangover. Government spending had got badly out of control and Portugal achieved the dubious honour of becoming the first of the 12 countries in the euro area to break the stability-pact ceilings on budget deficits. The government of José Manuel Durão Barroso was obliged to slash spending, freeze civil-service pay and raise taxes. The result, at least in the short term, was to make the recession worse. Mr Barroso's virtue has been rewarded this week with his appointment to the presidency of the European Commission. Portuguese virtue could yet be rewarded with higher growth. But there must have been many times when the Portuguese people cursed all that cash going into sky-boxes for football fans, while civil servants marched through the streets in protest at their pay freeze.

The economy is now at least expanding again, but the extravagance of spending on Euro 2004 may seem even more marked when the tournament is over. The Stadium of Light looks and sounds fantastic when capacity crowds of 65,000 roar on their teams. It could feel a little sad and empty during the normal Portuguese football season. Its normal occupant, Benfica football club, attracts an average attendance of 22,000. The figures are even starker for new stadiums outside Lisbon. The new Braga arena holds 30,000 supporters; FC Braga, the local team, attracts an average attendance of just over 5,000.

The tournament will surely give the Portuguese economy a bit of zing over the summer. For the past month it has been virtually impossible to find a hotel room in Lisbon or Porto. Super Bock, the local brewers, are reckoning on selling an extra 650,000 gallons of beer during the football tournament, although that figure may have to be revised downwards after the early elimination of England (along with

France, Germany, Italy and Spain). Overall, the government reckons that Euro 2004 will bring in some 200,000 extra visitors and generate rather over €100m ($120m) in extra tourist revenues. A welcome boost no doubt, but it hardly adds up to a transformation. If the football adds 0.2% to this year's GDP, Portugal will have done well.

The Portuguese (and Greeks, when their turn comes) hope that a successful tournament will also have a longer-term impact. Some dub this the “Barcelona effect”, in homage to the way that the 1992 Olympics showcased the Catalan capital, helping to turn it into one of Europe's most fashionable places for conferences and holidays. But such an effect is not inevitable. The image of Atlanta was not improved by the 1996 Olympics: if anything, the reverse. And Belgium did not become suddenly chic thanks to co-hosting Euro 2000. Had you forgotten that?

Portuguese men-of-war

Indeed, the economic arguments for hosting big sporting tournaments are largely spurious. The real case for Portugal taking on Euro 2004 is that sporting success seems to make people feel marvellously good. The English still drone on about winning the football World Cup at home in 1966. Danish supporters in Portugal carried banners bearing the date 1992: a reference not to the signature of the Maastricht treaty, but to Denmark's historic victory in that year's Euro tournament. For the past month the whole of Portugal has been agog as the national side, after an uncertain start, has progressed through the tournament, notching up heart-stopping victories over bigger, richer countries such as Spain, England and the Netherlands on the way. Against most expectations, the Portuguese may even carry off the championship in the final on July 4th. Who needs an empire, or an economic boom, if you can have moments as ecstatic as that?

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Education

Not just for the posh

Jul 1st 2004
From The Economist print edition

From class warfare to envy to emulation: Labour's growing love affair with independent schools

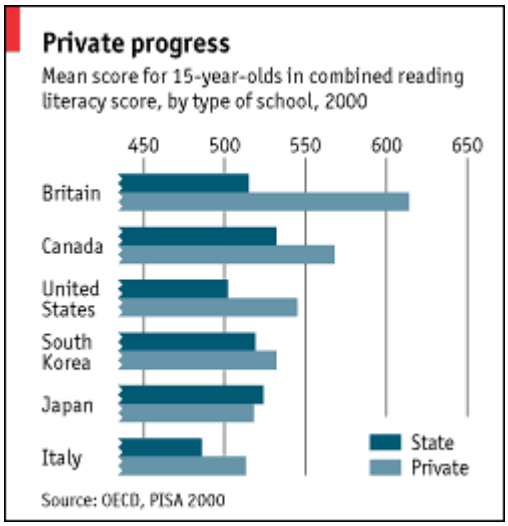
Get article background

PRIVATE schools have a special place in British socialist demonology: they entrench the class system, soak up the best pupils and teachers, and generally represent everything that Labour dislikes. Having failed to abolish them in the 1970s, Labour came to power in 1997 determined to be tough. It scrapped the assisted-places scheme—a modest scholarship programme for poor bright children. The private schools' charitable status came under scrutiny. And now the competition watchdog has started investigating curious similarities in the levels of fees they charge.

But the government hoped to do down the private schools mainly by improving state schools. It has splurged money on independently run and privately sponsored Academies. There are 12 of these at the moment, and Mr Blair is said to want 200 by 2010. It has also encouraged existing schools to specialise in particular subjects, again with private sponsorship: two-thirds have done so.

Initial results have been encouraging, but not conclusive—and certainly not enough to bring back fee-paying pupils. Their numbers have risen for nine years in a row; they are now 7.1% of the school population, despite stonking fee hikes.

A startling gap in achievement (see chart), mainly thanks to their better pupils and better teachers, explains the private schools' popularity. Nearly 80% of physics teachers in private schools, for example, have a physics degree; in state schools it's only 32%, according to Alan Smithers of the University of Liverpool. Take away the handful of surviving selective state schools, and the gap is even bigger.



Now Labour's prejudice against fee-paying schools has been overtaken by the hope that their excellence might rub off on the state system. In May the education secretary, Charles Clarke, told a conference of private schools that the taxpayer would pay them to teach state-sector pupils wanting to study seldom-taught subjects like classics. In effect, that revives the reviled assisted-places scheme.

Mr Clarke also made an offer of marriage: “There's been a history of mistrust between us. I want to move our relationship to a different level, and I hope you'll choose to work in partnership with me.” The government wants independent schools to sponsor Academies, as well as Foundation Schools, a new kind of autonomous outfit to be announced next week.

Some say there's great potential. The Church Schools Company, for example, which runs eight fee-paying schools, has a centralised administrative structure which can easily scale up to include Academies: it is sponsoring five, and plans to do more.

But that's atypical. Most independent schools are one-offs, without much scope for co-operation in training, recruitment and so on: certainly nothing of the kind that would help a bureaucracy-ridden state school. Where the private schools are truly strong, there is little spare capacity. Facilities are superior, but already well-used. Teachers are busy too. Fee-paying parents may get cross if real time and money

is diverted to helping state schools. And what is the point of a token effort?

Defenders of the rapprochement, such as Bernice McCabe, headmistress of North London Collegiate, a leading private girls' school that is sponsoring an Academy, insist that the circle can be squared. “The public-private divide is false,” she says. “People need to work together.” Her private-school parents, she says, want their daughters “to see a broader perspective and get ready for a wider world”. Perhaps—but it is hard not to imagine that some protective parents choose private schools for exactly the opposite reason.

Pinning down examples of co-operation beyond the trivial—sporting exchanges and the like—is tricky. The best ones are where the marginal cost of helping outsiders is not that great—in coaching state-school candidates for Oxbridge admission. That's fine. But it is hard to imagine that transforming anything except the lives of the handful of pupils concerned.

So most private schools are still sceptical. “If they're so impressed with us, why don't they look at what we do?” asks Elizabeth Diggory, High Mistress of London's well-regarded St Paul's Girls' School. Selection of pupils and freedom from state interference help to attract and retain good teachers, and to innovate beyond the bounds of the curriculum, she argues.

It's still hard to see Labour's partnership plans bridging the gap. But the Conservatives' ideas might. Their new education policy, announced this week, lets schools choose their admissions policies, including, if wanted, academic selection. That could, in effect, recreate the old grammar schools, which in past decades competed head-on with private schools.

The Conservatives also propose a voucher, worth on average £5,500, usable at private schools that charge no more than this. So far, few such low-cost schools exist, but GEMS, a Dubai-based education firm, plans to open 250 in coming years. They would be well placed for a voucher-driven market. Last week GEMS bought ten schools, on top of its existing three.

But there are drawbacks. Entrepreneurs may be chary of dealing with the artificial price cap in the Tory scheme, especially when combined with the vagaries of increasing regulation of schools and political uncertainty. And low-cost education may not be to everyone's taste. At the GEMS school in Milton Keynes, parents were surprised to learn recently about a sharp increase in class sizes. John Bridger, a director of GEMS, says there will be no difference in education quality. But a lot of parents think that small classes are a big reason for paying fees. Providing high standards on the cheap will be tricky, whoever is in power.

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Drug testing

Smoke signals

Jul 1st 2004
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Drug tests at work are common in America. Might they catch on in Britain?

AFTER the Reagan administration declared its war on drugs in the early 1980s, American firms began to check what their employees had been smoking over the weekend. A paper in *Social Justice Research*, an academic journal, found that while fewer than 5% of Fortune 500 companies had a drug-testing policy in 1982, 95% had one by 1995.

American management ideas often spread to Britain, so a study published by the Joseph Rowntree Foundation this week made interesting reading. According to a MORI poll for the report, 4% of British firms had such a policy in place last year and another 9% were planning to implement one this year.

Why are the tests gaining popularity? One reason why they are routine in America is that addicted workers who are seeking treatment count as disabled, so firms can't fire them. Screening new applicants for drug habits can save companies a lot of time and money.

British companies have different concerns. Health and safety is one reason employers give for taking up drug testing, but a report by the Health and Safety Executive in 2003 found five studies that suggested a link between drug use and accidents at work, and seven that did not.

Productivity is another, but the data are just as murky: the report says that evidence that drug use hurts efficiency is inconclusive. And, as Marcus Roberts of DrugScope, a think-tank that worked on the Rowntree report, argues: “If people are coming in to work unable to do their job properly, you don't need to start sampling their urine to know you've got a problem.”

What's more, the tests may run foul of the law. Their results would be classified as “sensitive personal information”, says James Davies of Lewis Silkin, a law firm. This could make employers who check for drugs vulnerable to legal action, although they might be able to justify it on health and safety grounds. This has yet to be tested in court.

So why are so many employers taking up testing? One possible answer is that it helps bosses deal with incompetent employees. Redundancy procedures are usually slow. Drug-testing can speed them up: if a company can prove a worker has been smoking something suspect as well as performing badly, he is that much easier to sack.

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Muslim voters

Coming unstuck

Jul 1st 2004 | LEICESTER
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The hunt for an elusive group of by-election voters

BY-ELECTIONS, held whenever an incumbent MP dies, retires or thinks of something better to do, are the closest that party strategists get to testing their potions on live animals. The lab is flush with party money, and alive with press officers from headquarters in London and, in the case of the Liberal Democrats, busloads of party activists enjoying a day out. If the election is in swing voter territory, like the Midlands seats of Leicester South and Birmingham Hodge Hill, where polls will be held on July 15th, then the bubbling test tubes are watched with special interest.

In Leicester South, the parties reckon that the swing voters are conveniently easy to recognise. They make up about 20% of the population, hang around the mosques and halal butchers in Spinney Hills and Stoneygate, and the more devout ones turn towards Mecca five times a day. They used to vote Labour, but are more suspicious of Tony Blair and his motives for invading Iraq than other voters. And they will be reminded of this when the Butler inquiry into the use of intelligence before the war reports on July 14th, filling front pages on election day.

The most direct bid for the Muslim vote is from Respect, an assortment of left-wingers and Muslims posing as a single issue anti-war party, which is fielding Yvonne Ridley, a journalist who was held hostage in Afghanistan and has since converted to Islam. But the main parties are trying hard too. Sir Peter Soulsby, Labour's candidate, describes the war in Iraq as “a mistake”. Liberal Democrat campaign leaflets about schools feature pictures of Mr Blair with George Bush. The Conservatives, who have to work harder than the other parties to attract Muslim voters, have set up call centres staffed by Urdu speakers.

Though being courted is pleasant, there is little evidence that Muslims vote as a group. Ibrahim Mogra, an imam who hails from Malawi and flies an England flag from the roof of his car, says that there have been discussions about how best to use a tactical Muslim vote. But these have fallen through due to lack of consensus between the mosques and a reluctance to push voters in a particular direction. “The mosques will tell people to vote, but not which party to vote for,” he says.

Muslims may not vote as a group, but, in the past at least, they mostly voted the same way. Since the 1970s, when people started counting, four out of five ethnic minority voters have consistently voted Labour. Bangladeshis and Pakistanis, the best proxy for Muslim voters, seem to have followed that pattern. In 1997, the most recent election for which voters have been sorted into ethnic groups, 85% of Pakistanis and Bangladeshis voted Labour.

There are signs that this is changing. In the local elections in 2003 the Lib Dems won all six seats in the two wards where Leicester South's Muslims live. A recent national poll of 500 Muslims by ICM showed they are prepared to look elsewhere in a parliamentary election too: 61% said they would vote Lib Dem or Conservative.

This is only partly down to anger over the war. Signs that the Muslims of Leicester South are becoming as fickle as other voters may mean they are becoming more middle-class. Shamit Saggar, a political scientist at the University of Sussex, says that the way Muslims vote has “precious little to do with the fact that they are Muslims” and everything to do with class and status. The party activists may want to bear this in mind when out hunting for the elusive Muslim vote.

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Chocolate

Stuffed

Jul 1st 2004
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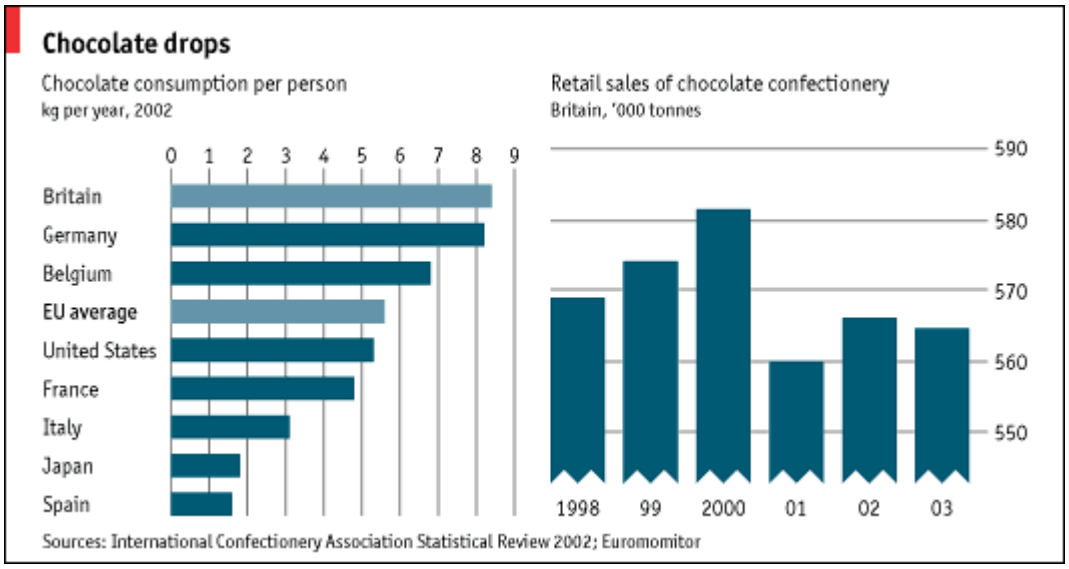

The British seem to be going off chocolate, but some bits of the market are doing deliciously well

IT'S usually nice to top an international league, but perhaps not this one. In the matter of chocolate consumption, Britain is (see chart) the most self-indulgent country among the world's big economies.

That may not last. Perhaps brow-beaten by the obesity scaremongerers, perhaps disgusted by their inability to see their toes, the British seem to be going off chocolate. The market has been static for five years and this is troubling Nestlé, Cadbury and Masterfoods, the three firms that dominate the British industry. “It's a saturated market,” says Jeremy Cunnington, an analyst for Euromonitor, a market research agency. “Penetration has gone as far as it can.” Mintel, another market research firm, agrees, predicting a slight drop in sales volume by 2006. With profits constrained by tight pricing on supermarket shelves, firms will focus more and more on extending a few superbrands with lasting appeal, subsuming existing products into them and trying to improve sales value rather than volume.

If they do, it will continue a trend towards emphasising established brand names instead of new ones. Cadbury has stopped selling its Wispa and Caramel products under their old names, bundling them under the Dairy Milk brand instead. Nestlé has been tinkering with its own big name, Kit Kat. A new version of the snack, Chunky, was launched in 1999, followed by bite-sized Kubes in 2003. There was even talk recently of a lemon cheesecake flavour—apparently popular with the Japanese and the Germans.

Not all the news is gloomy, though. There are lively niche markets, where consumers' sharpening social consciences and growing fondness for luxury have been lifting sales.

Clever companies satisfy both at once. Green & Black's, a small firm that sells expensive, organic GM-free chocolate, has seen its sales rise five-fold since 1999 to £23.4m in 2003. The firm has recently been moving away from its green roots to focus on its premium credentials, but “organic” and “premium” are linked in many people's minds.

The “fair trade” segment is another impressive performer. Such organisations guarantee producers in poor countries a minimum price, shielding them from the ups and downs of the world cocoa market. Figures from the Fairtrade Foundation show that Britain ate just over 1,000 tonnes of their chocolate in

2003, up from 82 tonnes in 1998—a 12-fold increase in five years, albeit from a very low base. The big players are beginning to cotton on, with the Co-op, a supermarket chain, announcing in 2002 that it would source all its own-brand chocolate from “fair trade” suppliers. Most British supermarkets now offer some sort of “fair trade” chocolate.

So will posh, socially responsible chocolate conquer the market? Unlikely, says Mr Cunnington. Luxury firms do not compete directly against the big companies—indeed their products have little in common. Most British chocolate contains vegetable solids, and tastes quite different from the “real” chocolate that the luxury firms offer. As for “fair trade”, higher prices for producers mean higher prices for consumers, limiting its appeal to a cost-conscious public. Although the two sectors are expected to continue growing strongly, they are unlikely to escape from their niches. The cocoa-leaf readers see a future of consolidation, limited innovation and a gentle decline in sales volume. Lemon cheesecake Kit Kats all round, then.

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Blunkett's latest battle

Who runs the police?

Jul 1st 2004
From The Economist print edition

Not the public—which is the real problem

TWO solid objects collided on June 22nd. Neither has cracked yet, but one must give way eventually. The first is David Westwood, the notoriously stubborn chief constable of Humberside Police, who was singled out for criticism in an official inquiry into the Soham murders. The second, harder, object is David Blunkett, the home secretary, who promptly demanded Mr Westwood's resignation—and, when he didn't get it, took the matter to the High Court. Senior police officers, who sense that a precedent will be set, are keenly watching the head-to-head confrontation.

Already, the collision has revealed just how difficult it is to work out who is in charge of the police. In contrast to America, where most forces are firmly under the thumb of a single authority (whether it be the federal government, county officials, a sheriff or a mayor), British bobbies have three competing masters. The immovable David Blunkett is one; the chief constables are another. Third are the police authorities, which are typically composed of councillors, magistrates and assorted local worthies. Police authorities are ancient institutions, vestiges of the 19th-century watch committees, which used to push chief constables around as though they were new boys at school.

Not these days, though. The police authorities' powers waned abruptly in the 1960s, when the police were reorganised after revelations of corruption; they have continued to decline ever since. As things stand, police authorities cannot remove chief constables without the say-so of the home secretary, although a home secretary has the power to sack a chief constable. Mr Blunkett chose to consult Humberside police authority over the removal of Mr Westwood, but this was a formality; when they voted against the proposal, the home secretary insinuated that they too were not doing their jobs properly, and headed to court.

All this sits oddly with the home secretary's desire, confessed at length in a June 2003 lecture, to get ordinary members of the public more involved in policing decisions. Noting that “the accountability of the police remains opaque, at best”, Mr Blunkett mused about the possibility of setting up elected police boards and delegating more power to local commanders. As for the possibility of tension between these more dynamic local arrangements and the centre, he was sanguine: “We must recognise, of course, a constructive tension between national consistency in performance and local responsiveness of police forces.”

As the Westwood affair has shown, though, this tension is not constructive at all—at least, not as far as local involvement in policing goes. Under pressure, localist ideals are forgotten, not because the home secretary is reflexively authoritarian, but because he is caught in what Tony Travers, of the London School of Economics, characterises as a social-democratic bind. Believing, along with other politicians of similar stamp, that it is the responsibility of government to ensure a minimum standard for the public services, Mr Blunkett feels obliged to step in whenever a local provider falls short of the mark. Weak institutions such as police authorities are shouldered aside as the two big players duke it out.

When the struggle between Mr Blunkett and Mr Westwood ends—almost certainly with the resignation of the latter—another, long-running one will resume. This is over targets and performance indicators, which are defined by the government, overseen (in part) by police authorities and deeply resented by senior officers for their distorting effect on crime-fighting priorities. As Peter Neyroud, chief constable of Thames Valley Police, suggests, the principle is much the same in both cases: “Central government has got to realise that it can't dictate everything.”

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Have-a-go heroes

Bravery's new face

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Immigrants uphold a British tradition

IT IS possible that native-born Londoners are less heroic than they used to be. Ninety-five years ago, a group of concerned citizens doggedly pursued two armed robbers across much of north London; of the 27 people injured in the chase, only seven wore uniform. Such acts of derring-do seem improbable now, mostly because the police have monopolised the use of force, but also because popular fears—of being injured or, more painfully, prosecuted—are that much greater.

The historical trend was not uppermost in the mind of João Henrique, a Brazilian technology consultant, who discovered a burglar in his flat last year. Mr Henrique, who is of slight build, coolly switched off the lights and, when the intruder came downstairs, bashed him over the head with a bottle. For his pains, Mr Henrique got his laptop back; to his great surprise, he was also rewarded with £500 from the public funds and a bit of pomp and circumstance at Blackfriars Crown Court on May 20th.

In this, as at other such events, a striking sociological pattern was evident. Most “have-a-go heroes” were, like Mr Henrique, young, male and foreign.

Why? It is partly to do with what new immigrants are exposed to. Many live in insalubrious areas, which means they are more likely to run into characters who might politely be described as “challenging”. They have had less time to soak up the orthodox theory on what to do in dangerous situations (essentially, not much). David Canter, who heads the centre for investigative psychology at the University of Liverpool, believes that confusion is part of the reason, too. New arrivals are likely to misread the cues given out by aggressive natives, and so under- or overestimate the threat they face.

Mr Henrique, who has now returned to Brazil, has a further explanation. “Maybe the British are more naturally peaceful, or maybe they are not used to the same level of violence,” he says. Having been mugged more than once, he is accustomed to calculating risk and response. Asked whether he would behaved in the same way had the burglary taken place in Brazil, he said he would; but rather than picking up a bottle, he might have looked for a knife.

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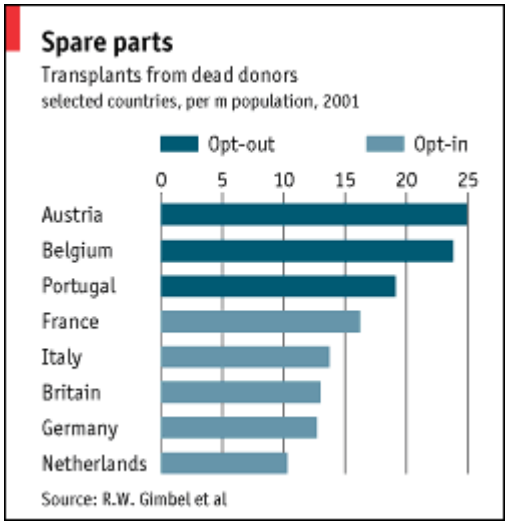
Organ donation

Thinking with your heart

Jul 1st 2004
From The Economist print edition

Why the government sank a proposal to make more transplant organs available



THE number of people waiting for a transplant in Britain has increased every year over the past decade, reaching 7,278 in 2003. Both transplant and donor numbers have declined over the same period. So it was with considerable interest, if not much hope, that surgeons watched Parliament vote on June 28th on an amendment to the Human Tissue Bill that would have turned Britain's current system of organ donation on its head.

At present, Britain operates an "opt-in" system whereby donors must sign a national register. Evan Harris, the Liberal Democrat MP who introduced the amendment, had hoped to replace this with an "opt-out" system under which the consent of the deceased would be presumed, unless the putative donor or close relatives had said otherwise.

While the Tories and the Liberal Democrats allowed a free vote on the issue, the government whipped its MPs into voting against it on the grounds that it was not the state's business to decide what should be done with people's bodies after death, and that there was little evidence that such a system would increase the number of organs available. So the measure failed.

A recent paper* suggests the government is wrong. Countries that operate an "opt-out" policy do indeed have a higher rate of donation, on average, than those that do not (see chart), although the difference is smaller than you might have supposed. Other factors, such as having the physical and managerial arrangements to support a big transplant service, were also important in determining the number of organs available for transplant.

But the government also had their worries. The spectre of two scandals in which children's hospitals were found to be removing the organs of dead patients without asking or even informing their parents still looms over the public consciousness. "The Human Tissue Bill was introduced in response to the Alder Hey and Bristol Royal Infirmary cases, which involved individual rights being ignored by people in authority," said Ian Lucas, a Labour MP. "It is fundamentally about ensuring that those terrible events do not recur."

Talk of "terrible events" may be putting things a bit strongly. The parents concerned were indeed distressed (and have been suing for compensation), but the utilitarian arguments for changing the law are strong ones. Great sensitivity to the question of consent may be politically convenient, but that is little comfort to those whose lives may depend on finding a donated organ.

*"Presumed Consent and Other Predictors of Cadaveric Organ Donation in Europe", by R.W. Gimbel et al, *Progress in Transplantation,* 2003 13 (1).

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Students

New frontiers

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From The Economist print edition

English students may sue the Scottish Executive for racial discrimination

WHEN does disadvantage turn into discrimination? It's a good question for a university seminar—but one that looks likely to become a real problem for some rather angry students at Scottish universities, as well as dons, politicians and the courts.

The problem is the Scottish Executive's decision to replace up-front undergraduate tuition fees with a total fee of £2,030, repayable through graduate tax on earnings of over £10,000. Under European Union (EU) law, this has to apply to all EU students studying in Scotland, except, oddly, to students from elsewhere in Britain: EU member states cannot discriminate against other member states' citizens, but they can discriminate against their own. So the Scots can charge English, Welsh and Northern Irish students the same up-front fees, now £3,600, as English universities. Jim Wallace, the Liberal Democrat Scottish universities minister, says he has to do this to stop English students flooding across the border to avoid fees, thus taking places away from Scottish students.

But Jack Rabinowicz, an education lawyer with Teacher Stern Selby, a London law firm acting for several students, says the policy looks discriminatory. Why should English, Welsh and Northern Irish students be the only nationalities to stump up?

Legal precedent (usually in cases where Scots complained of English discrimination) does say that Scots and English are distinct nationalities who ought not to be discriminated against. In a 1972 judgement Lord Simon of Glaisdale, an English appeal court judge, poetically declared: “The Scots are a nation because of Bannockburn and Flodden, Culloden and ‘The Pipes at Lucknow’ [a poem]. The English are a nation because Norman, Angevin and Tudor monarchs forged them together.”

Mr Rabinowicz says the discrimination will get worse when English fees rise in 2006, taking the maximum payable for three years to £9,000. Citing a 12% increase in applications by English students this year, Mr Wallace intends to hike English students' fees in 2006-07 to between £6,800 and £7,600. Otherwise, he says, English students will take advantage of the fact that a Scottish degree is £5,400 cheaper than one south of the border.

But his economics may be as wrong as his law. The Scottish degree takes four years, not three. The cost of an extra year studying (excluding fees) is £5,000-6,000, with the further loss of a year's earnings on top. Not that much advantage there.

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Bagehot

That eureka feeling

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Choice is an idea whose time has come. But where did it come from?

THE oddest thing about the decision of the two main parties to compete over how best to bring choice to key public services is just how long it has taken them to get round to it. If an idea is this good, what's been keeping it?

During their 18 years in power, the Conservatives showed very little interest in extending their reforming zeal to the National Health Service (NHS) or the school system. Cynics say that was because these were services that too few senior Tories depended on themselves. There may be a grain of truth in the accusation, but a likelier explanation is that the passions and energies of the Thatcher governments were spent elsewhere. Once the unions had been tackled and the public utilities privatised and exposed to competition, there was, as John Major subsequently demonstrated, nothing left in the tank.

Besides, even Tory radicals were loth to tamper with the NHS. Nigel Lawson, a former chancellor, observed that it was the closest thing the British had to a national religion. Taking on the miners was one thing, tangling with the nurses and the doctors quite another. As for schools, although late in the day the Tories came up with the notion of money following pupils, successive Conservative education ministers had neither the mettle nor the cunning to confront an educational establishment united in its devotion to the “comprehensive ideal”.

Even in opposition, the Tories were reluctant to stake out a distinctive position on issues that tradition dictated belonged to Labour. So why have things changed? Partly because of the 2001 election, when the party's *Daily Mail*-inspired agenda of crime, immigration and Europe failed to make headway. Partly because of Labour's difficulty in showing that the money it has lavished on public services has been well spent. But it is also because Michael Howard reckons that Tony Blair's prescriptions for the NHS and schools are closer to Tory thinking than they are to Labour's. Mr Blair, he thinks, has inadvertently shifted the battleground into Tory territory.

To get to where he is now, Mr Blair has been on a slow and painful journey. Between winning Labour's leadership in 1994 and becoming prime minister three years later, Mr Blair's focus was on making Labour electable, not on what it would actually do in government to improve public services. The result was more than half a parliament frittered away, while Labour's instinctive hostility to applying market forces to public services drove the government to discard the few good ideas bequeathed by the Tories. When the public services duly failed to improve, Mr Blair's inadequate answer was to give them targets, loads of money and new ministers. Without a clear framework of ideas, he was still groping in the dark.

The 2001 manifesto provided the opportunity for more rigorous thinking. Mr Blair's authority was massive at the time, and he could have used it to radicalise the party's programme. But he allowed himself to be distracted, first by protests against high fuel prices and then by the foot-and-mouth epidemic. As a result, the manifesto relied more on “investment” in the public services (otherwise known as spending) than on reform.

But the problem was not just Mr Blair's fitful attention. It was also that, as part of the deal he had done with Gordon Brown over the leadership of the party, Mr Blair had in effect ceded control of domestic policy to the chancellor. And, although this has given Mr Brown great power, which he has jealously guarded, his range of interests is surprisingly narrow. What really turns him on, apart from macroeconomic policy, are welfare and labour-market issues such as reducing child poverty and getting unemployed people back to work. Health and education don't seem to engage his large intellect.

Derek Wanless's report on the future of the NHS, published in 2002 and sponsored by Mr Brown,

bolstered the argument for giving the health service more money and for continuing to fund it through the tax system. But it had little to say about how the NHS should be run. On other areas of public service reform, too, Mr Brown has preferred to snipe from the sidelines rather than explain his own thinking: when Mr Blair was fighting for differential university tuition fees, Mr Brown allowed the impression to grow that he was hostile to the proposal, but offered no sensible alternative of his own. In his new biography of Tony Blair (see article), Anthony Seldon argues that Mr Brown's sulky reluctance to apply his strategic talents to health and education has cost the government dear.

Take your choice

Two years ago, when Mr Blair was on his summer holiday, it suddenly seemed obvious to him what had to be done. What was needed to create a virtuous circle in both health and education was a combination of money to fund extra capacity, competition between providers, and users able to choose between them. Timidly in education, slightly more boldly in health, Mr Blair at last finds himself going in the right direction. His strength is that the voters trust Labour with public services; his weakness that his radicalism is diluted by the need to appease Mr Brown and prevent explosions from suspicious Labour MPs.

That is Mr Howard's opportunity. He claims that because choice fits more comfortably with Tory instincts, he can go further and faster than Mr Blair. He may well be right. He can think more boldly than Mr Blair, but he is vulnerable to the Tories' legacy of neglect of the public services.

Having taken an age, and different paths, to get there, both are now determined to fight the election on the same issue. Mr Blair still expects to win, but, in the last fortnight, Mr Howard has put the Tories back in the game. What makes it a fascinating match is the way the strength of one so exactly mirrors the weakness of the other.

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Energy

Europe's power struggle

Jul 1st 2004 | BRUSSELS
From The Economist print edition

Europe's energy markets are struggling towards freedom. But they are not there yet

“FREE Gulliver!” declared Philippe de Buck at a recent gathering of European regulators, utility bosses and others involved in energy liberalisation. The secretary-general of the Union of Industrial and Employers' Confederations of Europe urged them to “take their hands off the management of the energy business” and added, “Don't turn back the process of deregulation.” Only thus, he argued, will Gulliver be liberated from the thousands of “Lilliputian rules and restrictions that bind him”. His timing was curious, to say the least, for July 1st marked a crucial step in the emergence of the EU as the world's most liberalised large energy market.

The conference that Mr de Buck addressed, in Lyon, France, celebrated the latest advance in the decade-long process of European Union (EU) energy liberalisation. The first big threshold was passed in 1999, when some large firms were allowed to choose their power suppliers. Since July 1st, two-thirds of all customers in Europe have had that right, at least on paper. By 2007, every European will.

As recently as three years ago, such progress was unimaginable. France and (with more subtlety) Germany were doing all they could to put off the moment of market opening, blocking negotiations and actively boosting their domestic champions in the energy business. But Europe's energy dinosaurs lost the latest round in the liberalisation fight, beaten by political pressure from the pro-market British and Dutch, and by the tireless work for change of the European Commission. The Commission is even now demanding that the overblown giant, Electricité de France (EDF), return some €1 billion ($1.1 billion) in illegal state aid (see article) for an account of EDF's ever-expanding problems). The Commission is also opposing the British government's bail-out of British Energy, an ailing nuclear operator.

Philip Lowe, who heads the Commission's competition directorate, argues that the hard work of liberalisation goes mostly unnoticed. His unit has cracked down on colluding Norwegian gas firms. It insisted that Algerian gas imports not have “destination clauses” that forbid resale; it sided with Marathon Oil, an energy company trying to enter the German market, when Germany's Thyssengas refused it access to its network; and it ordered EDF to auction capacity on its link between France and Britain to newcomers. The liberalisation process is, says Mr Lowe, “a constant grinding away at the nitty-gritty of anti-competitive behaviour”.

Even executives of the industry being pushed to liberalise have some kind words for the Eurocrats. Paul Bulteel, secretary-general of Eurelectric, a trade group, says that “despite some flaws, the Commission

has done a very good job ensuring that there is a coherent regulatory framework. This is much better than the patchwork that exists in the United States."

That is no idle boast. July 1st brought more than just a mandatory choice of supplier. Vertically integrated firms must now legally "unbundle" the grid from their supply business. (With luck, supply giants such as Gaz de France and Italy's ENEL will now be forced to sell off their grids so that they have no way to discriminate against new entrants.) All EU countries must now have an energy regulator; before July 1st, Germany doggedly refused to establish one. That, complains Gérard Mestrallet of Suez, a French rival to EDF, meant that foreign firms had to haggle with (or sue) provincial utilities to get them to ship power to clients within Germany, which meant that in practice liberalisation in Germany fell far short of how it looked on paper. A final, related, advance is that every country must now have transparent tariffs for using the transmission system.

Let there be light

So why, given all this progress, did Mr de Buck strike such a cautionary note? Certainly, there is a chance, albeit small, that the reforms will even now be derailed. Perhaps the growing public backlash against blackouts will prompt political action. Last summer's blackouts from England to Italy led some politicians to call for more state intervention to ensure "security of supply". Loyola de Palacio, the EU's Energy Commissioner, rejects that link: "The blackouts in Europe last year cannot be blamed on the market-opening process."

A more serious worry, that might lead to a rethink, is that deregulation would undermine incentives to make essential investment in new generation and transmission. Fatih Birol, chief economist at the International Energy Agency, estimates that 40% of western Europe's coal plants will need to be replaced by 2015.

A lesson from America, which endured its worst blackout ever last August, is that a half-baked approach to deregulation reduces incentives to invest. But so does arbitrary state intervention, such as the imposition of price caps on wholesale markets during California's energy crisis. In contrast, Britain's more coherent regulatory approach has delivered better results. After privatisation, Britain's National Grid company invested in upgrading transmission lines at four times the rate it did before it was sold. Security of supply comes not from central planning, but from a well-regulated, open market.

Another fear is that liberalisation will be sacrificed to greenery. The EU prides itself on being the world leader in tackling climate change, by promoting renewable energy and other environmentally friendly technologies. Alas, each EU member country has embraced its own, often muddled, set of energy taxes, wind subsidies, carbon-reduction schemes and so on. Eurelectric complains that this has led to "an incoherent and market-distorting patchwork" that deters investment. Far better, it argues, is a market-friendly approach that builds on current plans for pan-EU carbon trading (due next year).

But the biggest challenge will come from the entrenched old monopolists, who have lost some of their strength but are seeking new ways to stitch things up. In France, new power firms seeking small customers will find that many do not have sophisticated electronic meters; they must rely on load and risk profiles provided by the mighty incumbent, EDF. And EDF has used the fruits of its monopoly power in France to buy its way into more deregulated foreign markets. As Paolo Scaroni, ENEL'S boss, puts it, EDF has been "pushing forward on liberalisation abroad—but it's very reluctant at home."

There are rumours of impending "asset swaps" (via asset sales) or "energy swaps" (via long-term contracts) among national champions such as EDF, ENEL and Endesa. That would allow some foreign penetration while keeping newcomers out and so limiting the amount of competition.

In Spain, a serious obstacle to competition is that the Iberian power grid is poorly connected to the rest of Europe. But "what incentive does a supposedly unbundled Spanish grid operator have to build new interconnections to France?" asks one Commission regulator. Such connections would only let in a flood of cheap nuclear electricity. Italy's regulator worries about the grip that ENI, a national oil giant, has on the gas infrastructure.

So how can a stitch-up by various national incumbents be avoided? That regulators are already alarmed is a hopeful sign, although it does not satisfy Suez's Mr Mestrallet. He wants a new pan-EU energy regulator, a "super policeman", to ensure that Europe builds the inter-connections necessary to forge its balkanised national markets into a "high voltage highway".

That sounds like a Eurocrat's dream, but Brussels is not interested. Rather, officials say that existing forums for co-ordinating regulatory efforts, as well as various bits of EU legislation, are adequate to the task. Indeed, despite the fears of Mr de Buck, it is clear that the often vilified Eurocrats are feeling unusually optimistic about energy liberalisation. Says one top Commission official neck-deep in reforms: “My aim is to shut down this office on January 1st 2007. I'd like to put myself out of a job because we'll have a fully competitive energy market and there will be no need for our services.” Here's hoping.

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Hollywood

Moore money

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Hollywood is waking up to the fact that controversial films are raking it in

AP

Gross record breaker

TWO hugely popular, hugely controversial movies have left Hollywood's big studios looking red-faced for passing up the chance to profit from them. “Fahrenheit 9/11”, Michael Moore's flawed but entertaining George Bush-bashing “documentary” has grossed a record $24m in its opening weekend, having cost $16m (see article). Disney had controversially decided not to distribute the movie. Earlier this year, the big studios shunned “The Passion of the Christ”, produced by Mel Gibson, partly because of accusations that it was anti-semitic. It went on to rake in $370m, making it the seventh-highest grossing film ever.

Disney's official justification for preventing its Miramax subsidiary from distributing “Fahrenheit 9/11” was that the half or more of America that disagreed with Mr Moore's views might avenge itself on the firm's products and services. “Eisner made the right decision to not use Disney shareholders' money to advocate a partisan political position,” says Herbert Allen, president and chief executive officer of Allen & Co, an investment bank in New York.

Other media executives suspect that Disney's boss, Michael Eisner, also hoped to make life difficult for Harvey and Bob Weinstein at Miramax, with whom he has a fraught relationship. The Weinstein brothers had to buy the film themselves and use a smaller distributor, Lions Gate—something that seemed riskier at the time than it looks now.

Hollywood may be a bit braver in future. Rupert Murdoch, boss of News Corporation, recently told his number two, Peter Chernin, that he was disappointed at his decision to pass over “The Passion”. Mr Murdoch liked the film—and would have liked the money too.

Politically controversial movies often benefit from lots of free publicity. They can expand the market for films, as the people who flock to them tend to avoid Hollywood's typical fare. When Mike Dunn, president of home entertainment at Twentieth Century Fox, went to see “Fahrenheit 9/11” in Woodland Hills, Los Angeles, he noticed that many in the audience had not been to a movie for ages. “They didn't even know how to buy a ticket, and bitched about the price of the Coke,” he says. Almost one-third of the audience at “The Passion”, he says, had not been to the movies in the past year.

Now studios are jostling to win the home-video rights for “Fahrenheit 9/11”. Sony Pictures is said to be in the lead. Twentieth Century Fox's home entertainment division will release “The Passion” in August and, later, “The Hunting of the President”, a documentary about an alleged right-wing conspiracy against Bill and Hillary Clinton. The surest guard against self-censorship by America's media giants, it seems, is big box office.

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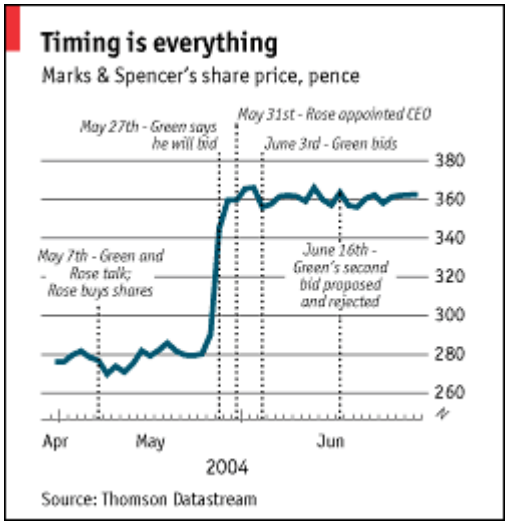
Marks & Spencer

Dirty linen

Jul 1st 2004
From The Economist print edition

The battle for one of Britain's top retailers turns nasty



WITH hindsight, Stuart Rose may regret having bought 100,000 shares in Marks & Spencer, the firm he now runs, because it has made his tough new job more difficult. But he is adamant that, at the time of the purchase, he did not know that his old friend and rival, Philip Green, planned to make a takeover bid, which has now been increased to at least £8.4 billion ($15.3 billion), for the iconic British retailer. Nor, insists Mr Rose, did he know that, as part of its pre-emptive defence, M&S would ask him to be its new boss. "If I had done something wrong I would step down from the company. I have done nothing wrong," he told the BBC.

Now Britain's Financial Services Authority (FSA) is investigating dealings in M&S shares, which started to increase sharply in value shortly before the bid (see chart). But the inquiry is only one of many distractions for Mr Rose as he prepares for the unveiling on July 12th of his strategy to revive a business that was once in the vanguard of global retailing.

Ever since an altercation between Mr Rose and Mr Green outside M&S's London head office soon after Mr Rose's appointment, things had seemed likely to turn nasty. Why did someone try to get hold of Mr Rose's mobile-phone records? Who else made well-timed purchases of M&S shares before the bid? And what was really said about Mr Green's bid team to a financier visiting the Chelsea Flower Show? All intriguing enough questions to make British newspaper headlines in a quiet week.

The M&S board, which complains of "material factual inaccuracies and innuendo" in some of the newspaper reports, says it is standing behind Mr Rose. "Stuart will not allow himself to be distracted from the task in hand, of maximising value for shareholders," says Paul Myners, the M&S chairman. Mr Green says that any shenanigans have nothing to do with him. Indeed he was once the victim of such things: his first attempt to buy M&S was in part thwarted by what he describes as a "dirty-tricks" campaign against him. Mr Green also backs Mr Rose's story. Although Mr Green rang Mr Rose on May 7th—the day Mr Rose bought his shares—to invite him to a meeting, he says that nothing was said about M&S until the pair met five days later and, in confidence, he revealed details of his plan to buy M&S.

For shareholders, whom to back in the takeover battle had seemed a fairly simple choice: stick with Mr Rose or take Mr Green's bid (twice rejected by the board) which also provides an option to retain a stake in the company. Both men have plenty of retailing experience and so are well-qualified to rebuild M&S. The issue, it seemed, would boil down to which person was thought to be the better retailer.

That question will again be to the fore when Mr Rose announces his plans for reviving M&S and Mr Green responds to them. Mr Rose is likely to reveal a back-to-basics strategy for the 100-year-old retailer, with a more focussed product range and a simplified supply chain. Mr Green has talked about doing similar things. But with an FSA inquiry hovering in the background, the battle has become more complicated. And it may not be resolved soon; investigations into possible insider dealings can drag on for years in Britain.

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The digital home

Life in the vault

Jul 1st 2004 | SAN FRANCISCO
From The Economist print edition

Companies are fighting to turn your home into an entertainment multiplex

ON JUNE 21st, Intel, the world's largest chipmaker, launched two new lines of chips, code-named Grantsdale and Alderwood, which it says are the “most compelling” changes to the way personal computers (PCs) work in “over a decade”. From here on, claims Intel, PCs will be “all-in-one hi-fi devices”, “entertainment PCs”, and “vaults” for digital content.

Intel's vision is that consumers will start to use their PCs at home to download, store and manage films, songs and games, in order to transmit all this fun stuff wirelessly to TV screens and stereo speakers throughout the house. The kids could then watch “Shrek 2” in the basement, while mum listens to Brahms in the kitchen and dad browses the holiday pictures on the main TV screen in the living room.

As such, Intel's vision is neither new nor overly ambitious. For years, futurists have been peddling notions of digital nirvana in the home. In its wilder forms, this includes fridges that know automatically when to re-order milk via the internet, garage doors that open by themselves as the car approaches, and toilet seats that warm up at just the right moment.

Most of this is guff. Nobody, aside from the self-selected early adopters at trade shows, would consider “upgrading” a garage door every few years for the latest release. “In 20 years, my PC will still not be talking to my fridge,” says Jen-Hsun Huang, the chief executive of NVIDIA, the world's largest maker of graphics chips.

On the other hand, says Mr Huang, “the vision of digital content is a much more compelling one than that of home automation.” And this is why the new chips may turn out to be as important as Intel claims. They are an opening salvo in a battle between the computer and the consumer-electronics industries over who will dominate the digital household.

Intel, with a virtual monopoly in the chips that power PCs, naturally hopes that PCs will dominate and morph into “media hubs”. So does Microsoft, with its near-monopoly on PC operating systems. HP, Gateway, Dell and Apple also want the PC to win, although HP is also big in printers, digital cameras and other consumer gizmos, and Apple has the iPod to fall back on.

On the other side are the giants of consumer electronics. Sony wants future versions of its game consoles, rather than PCs, to play the role of digital “hub”. TiVo, a leading maker of digital personal video recorders (PVRs), has hopes for its machines. So do makers of TV set-top boxes.

Extrapolating from history, the PC industry would be the favourite to win, since it has the powerful and rich Microsoft on its side. Microsoft is certainly trying. In the past year, it has launched and re-launched its Windows Media Center, a version of its operating system that looks more like a TV menu and can work via a remote control. Microsoft is also pushing its own next-generation DVD technology, that competes with rival technologies from Japan's Matsushita, NEC, Toshiba and others.

Microsoft's problem is that consumers do not seem keen. Only 32% of American households with internet access polled by Parks Associates, a consumer-technology consultancy, said they were “comfortable” with their PC becoming an entertainment system. Nobody wants to watch the system reboot during a good movie.

This scepticism, however, does not automatically mean that the consumer-electronics industry will win. The one thing that all companies seem to agree on is that households will be connected to the internet via a broadband link that is always on, and that content will be shared wirelessly between rooms within

the home. The upshot is that there need not be any single device inside the home that becomes a central media hub. A baby picture could be stored on a PC, on a console, or on a mobile-phone handset. Or it might alternatively be kept on a remote and powerful “server” computer somewhere on the internet. The latter model is how subscribers to Rhapsody, a service provided by RealNetworks, an internet media firm, already listen to music.

The gadget makers therefore have much to ponder. Art Peck, an analyst at Boston Consulting Group, says that the real money in the digital home will be made by those providing a service or selling advertising. The hardware makers, he thinks, are therefore fooling themselves by thinking that any device can become a “Trojan horse” to enable them to capture the bounty. It is much more likely that they will all end up as makers of interchangeable commodities for the digital home, that the consumer cares little about unless the stuff breaks down.

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Business in Germany

New jobs shock

Jul 1st 2004 | FRANKFURT
From The Economist print edition

Some rare good news from Germany

WHEN the bosses of two global firms—Jeffrey Immelt of General Electric and Heinrich von Pierer of Siemens—met briefly in Bavaria this week, they each had something to celebrate. Mr Immelt was about to open GE's first research and development centre in continental Europe, at Garching near Munich. And Mr von Pierer had saved 2,000 jobs in North-Rhine Westphalia that might have gone to Hungary: he had persuaded IG Metall, the country's biggest blue-collar trade union, to agree that the firm could make greater use of flexible working hours.

Both developments put a more positive spin on Germany as a business location than it has enjoyed for a while, and offset somewhat the news that during June the business climate index measured by the Ifo Institute for Economic Research fell by an unexpectedly dramatic 1.4 points.

GE's investment of $52m in the research centre, which will initially employ 150 scientists, was seized on by local politicians as a show of confidence in German technical know-how. The centre is on the campus of Munich's Technical University and will draw on local talent. GE already has 7,000 employees in Germany, building wind-power turbines and medical equipment and selling financial services. Its new research centre is a smaller version of others in New York, Bangalore and Shanghai. But it reflects a commitment to Europe that Mr Immelt's predecessor Jack Welch did not share. (GE has also made Amersham International, a British firm it bought last year, its global centre for medical-technology research.)

Siemens, with headquarters only a few miles away, claims to be untroubled by GE's challenge so close to its home. The German firm has bigger worries—inflexible labour laws in particular. On June 24th it won the agreement of IG Metall that workers making mobile and cordless phones at two plants near Cologne would work for up to 40 hours a week, rather than the previous maximum of 35, for no extra pay. It also established that the 35-hour limit could similarly be raised at any of its 105 German units whose viability had been threatened.

This success has been hailed by some commentators as a breakthrough in German labour relations. Some employers see a chance to re-establish the German work ethic which created the *Wirtschaftswunder* and then skipped a generation or two. But that is probably wishful thinking. The best that realistically can be hoped for is more flexibility, case by case, as employers present unions and other workers' representatives with stark economic choices.

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Asian business

Pigtails and tall tales

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An Asian business shows that nobody fights like a family

IN ONE corner is Nina Wang, Asia's richest woman, with a fortune of HK$19 billion ($2.4 billion), according to *Forbes* magazine. Even at the age of 66 she is still known in Hong Kong as “Little Sweetie” because of her diminutive stature and fondness for wearing girly pigtails, bobby socks and micro-miniskirts. In the other corner is her 93-year-old father-in-law, Wang Din-shin.

The battle is for control of Chinachem, Hong Kong's largest private property developer with an annual turnover of HK$27 billion, as well as assets such as vineyards and meat-packing plants on the mainland, interests in a Taiwanese shipping line and stakes in American drug companies. The empire was put together by Teddy Wang, husband to Nina and son to Din-shin, who disappeared in 1990 after being kidnapped—for the second time—and was declared legally dead nine years later.

Reuters

Where there's a will there's a Wang

Since then Nina and her father-in-law have been abusing each other in court, setting a local record with a 172-day trial described by the presiding judge as “a chimera with a fire-breathing mouth that devoured a significant part of our judicial capacity”. Ms Wang contends that a will drawn up in 1990 and signed by Teddy a month before his disappearance left everything to her—not least because he was upset, her lawyers claim, by his father's “womanising”. Mr Wang senior argues that a will made by his son in 1968 named him as the sole executor and trustee of the estate and that Teddy had decided to leave nothing to his wife, whom he began wooing when she was 13, after he discovered that she was having an affair. It was only after Ms Wang failed to stop her father-in-law from declaring Teddy legally dead (his body has never been found and Ms Wang insists that he is alive and trying to contact her) that she produced the hand-written will that made her sole heir.

On June 28th, a Court of Appeal in Hong Kong ruled in favour of Mr Wang senior, declaring the 1990 will a fake. But the judges said that there was not enough evidence to prove that Ms Wang forged the document—a charge she was arrested and bailed for in 2002.

Ms Wang may take the case to a final appeal. To strengthen her position, she has apparently been buying more shares in Chinachem, which she chairs, and through which she has tried to make her mark (though her plans to construct the world's tallest building, the Nina Tower, were vetoed by Hong Kong's government in 1994). But the older Mr Wang may only have to wait for the courts to restore his control of the firm he founded. Meanwhile, the mudslinging is a reminder that, for all their virtues, family-controlled companies—of which Asia still has many—are vulnerable if the family is at war with itself.

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Spanish business

Whose head will roll?

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From The Economist print edition

The new Socialist government's impact on Spanish business

SPAIN'S shock change of government in March has left its corporate bosses all a-fluster. They do not know whether the new Socialist prime minister, José Luis Rodríguez Zapatero, will poke his nose into business as much as did José María Aznar, his centre-right predecessor. Above all, they are wondering if he will let them keep their jobs. In the past, a change of government in Spain has often been followed by a purge of company bosses with connections to the opposite political camp.

Last week Pedro Mielgo, the well-regarded boss of Red Eléctrica de España, a 29% state-owned company that operates most of Spain's high-voltage electricity cable, had to step aside for Luis Atienza, a former Socialist minister. Reports in the Spanish press say that two board members of Teléfonica, a telecoms giant, will be replaced by Carlos Solchaga, a former Socialist economics minister, and Claudio Aranzadi, a former minister of industry. The job of César Alierta, the boss of Teléfonica, is rumoured to be on the line.

The privatisation of many big Spanish firms has not ended the state's influence over them, though it has been weakened to an extent that may soon become clear. Mr Zapatero has tried to ease worries about the state's heavy hand. He appointed a reassuring economics minister, Pedro Solbes, a former European commissioner for monetary affairs. His economic adviser is Miguel Sebastián, a well-respected economist, who says that the government's economic policy will be inspired by America's under Bill Clinton.

Yet Mr Aznar, when he became prime minister, paid lip service to free competition too, only to engage in complicated telephone diplomacy to secure top jobs in newly privatised companies for his friends. “Aznar's men were control freaks,” says William Chislett at the Real Instituto Elcano, a think tank in Madrid. In 1996 Alfonso Cortina, a close friend of Rodrigo Rato, Mr Aznar's economics minister, replaced Óscar Fanjul as boss of Repsol, an oil and gas firm. Mr Alierta, another friend of Mr Rato's, took over at Telefónica in 2000. Pablo Isla succeeded Mr Alierta at the helm of Tabacalera. Manuel Pizarro, an ally of Mr Aznar, became boss of Endesa, an energy utility, in 2002. Fernando Conte became top dog at Iberia, the national airline, in 2003. Many observers think that the ties of Messrs Cortina, Pizarro, Alierta, Isla and Conte to the party that lost the elections will now cost them their job.

Mr Zapatero has ways to exert control even over privatised firms, should he wish to. The government has golden shares in many of them, giving it the right to veto important decisions—despite the European Court of Justice declaring such shares illegal. Though entirely in private hands, firms such as Repsol and Teléfonica are subject to government regulation. (Mr Solbes is planning to free the competition authority from state influence, but the regulators for energy and for telecoms, as well as the stock-exchange commission, are likely to remain under government control.) If their boards or big shareholders are made aware that the government is likely to regulate less favourably while the current boss remains in place, they will know what to do. Mr Cortina of Repsol, one of the most heavily regulated firms, is widely tipped to lose his job soon.

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The soccer business

The Real deal

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David Beckham meets the Lion King

Get article background

AP

Spot the brand

WHEN Florentino Pérez, president of Real Madrid football club, began to buy many of the world's most famous footballers, some observers dismissed his actions as a sign of megalomania. Yet according to a new study by the Harvard Business School (HBS) there was method in Mr Pérez's apparent madness.

In 2000, Real broke football's world-transfer record by paying €59.8m ($56m) to sign Luis Figo of Portugal; the following year the club paid even more, €75.5m, to secure the services of Zinedine Zidane, the star of the French national side; the next year Real Madrid bought Ronaldo, the top scorer in the 2002 World Cup; the year after that it swooped for David Beckham, England's captain and fashion icon. According to HBS, Real was doing more than simply fulfilling the fantasies of its supporters and owners: it was actually pursuing a well thought-out business strategy—turning itself from a mere soccer team into a global media brand.

Real's managers studied how Disney had marketed the film, “The Lion King”. Their key insight was that selling tickets to the movie was not the main source of revenue; the big money lay in spin-offs and merchandise. Buying a team full of *galacticos* (superstars) was meant to make Real the leading brand in world football, creating new revenue, from sponsorship to shirt sales. The goal was to overtake Manchester United, Mr Beckham's former employer, which became the richest club in world soccer thanks not least to pioneering the idea of turning its team into a media brand. (United recently hired a former Disney executive, Andy Anson, as its commercial director.)

Real's strategy has largely worked. Although the latest rankings by Deloitte, an accounting firm, show Real as only the fourth-biggest club in the world by turnover, its management has done well at developing new streams of income. While the biggest source of revenue for Manchester United remains surprisingly prosaic—sales of tickets to matches—Real's commercial revenues now exceed ticket sales and revenue from broadcasting. HBS reports that “marketing revenue was expected to rise from €39m in 2000-01 to €83m in 2003-04.”

Yet there may be a small flaw in Real's strategy. Footballers—unlike the cartoon characters of “Lion King”—are human beings, with all the frailty which that implies. For the first time in years, in 2004 Real failed to win any major trophies. And in the current European football championship, the brand value of many of its stars has taken a dive. Raul, captain of Spain and Real, barely got a kick as his country was eliminated; Mr Beckham missed two crucial penalty kicks and played well below par; Mr Zidane could not prevent France's early exit. Indeed, going into the final week of the tournament, Mr Figo of Portugal was the last Real *galactico* left standing. And he was mostly out-shone by Cristiano Ronaldo, a new Portuguese star who plays for—oh, curses—Manchester United.

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Face value

The quiet iconoclast

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With KaZaA, Niklas Zennstrom undermined the music industry. Now he has telecoms firms in his sights

THERE is no shortage of aspiring iconoclasts in the technology industry. Start-ups are generally headed by brash, outspoken types who push their ideas with evangelical zeal, making big claims about how they will conquer the world, topple industry giants and overturn existing business practice. Not so Niklas Zennstrom, a 38-year-old Swedish entrepreneur. Measured and soft-spoken, and fond of historical analogies, he makes big claims but does so calmly, certain that history is on his side. This quiet man has a record that any iconoclast would envy.

KaZaA, the firm he co-founded with Janus Friis, his Danish sidekick, struck fear into the heart of music-industry executives when it became synonymous with internet file-swapping after the shutdown of Napster. Now he and Mr Friis have taken the experience they gained from KaZaA (which is now in decline amid a sustained legal assault) and applied it in another field that is dominated by stodgy, dinosaur-like firms with prehistoric business models: telecoms. Skype, their latest creation, is an attempt to Napsterise the phone business. Whereas KaZaA offered internet users free music, Skype offers free phone calls. Better still, it is entirely legal—and might, some day, even be profitable.

On the face of it, file-swapping and telephony have little in common. But both, it turns out, can be implemented using “peer-to-peer” technology, in which PCs connected to the internet via broadband connections organise themselves into a network. It is then possible to send data, whether media files or phone calls, from one PC to another efficiently. Many of the lessons that Mr Zennstrom and Mr Friis learned from building the file-sharing system behind KaZaA—in particular, the idea that some computers should act as “supernodes” to speed the transfer of data—could thus be applied to internet telephony through Skype. The supernodes, for instance, help to eliminate the delays and drop-outs that can plague internet telephony.

Of course, transmitting sound in real time is far more challenging than delivering a music file or even, say, an episode of “The West Wing”, from one PC to another. But Skype does it, and does it surprisingly well. It is easy to set up and use, the sound quality is impressive, and the software also supports conference calling and instant messaging. Since its launch last August, the Skype software has been downloaded over 14m times, and now has over 6m regular users—and all without any advertising. That was another lesson learned from KaZaA, says Mr Zennstrom: “If you want to spread software to a large group of people, it must be simple, not need configuration, and give you instant gratification.” Skype runs on Windows-based PCs, some kinds of handheld computers and, as of last week, on Linux too.

So far, Skype users have only been able to call other Skype users from their PCs. But the latest version of the software, which is now being tested, allows Skype users to call ordinary telephones too. While Skype-to-Skype calls remain free, users must pay to call ordinary phones: but rates are low, with most calls costing around 1 cent a minute. This puts Skype in direct competition with traditional phone companies, alongside a growing band of other small firms that offer low-cost telephony by routing calls partly over the internet. By bypassing the traditional phone network as much as possible, they can avoid the fees charged by traditional operators for carrying calls over their wires.

But Mr Zennstrom thinks that merely linking traditional and internet-based phone systems is an inelegant

halfway house. He is more radical, believing that all calls will migrate to the internet and be provided via software alone, with no need for any dedicated infrastructure. Telephony will be another free internet service, like e-mail and web browsing are today. (Skype plans to make money by charging for extras such as voice-mail, call waiting, multiple lines and calls to the few die-hards who stick with pre-internet phones.) If he is right, the traditional fixed-line voice business will shrivel and die, and telecoms incumbents will be reduced to selling broadband access, and little else.

Mr Zennstrom has competed with telecoms giants before, having worked at Tele2, then a small Swedish operator, during the 1990s. He came to the conclusion that only a radically new approach to telephony would ever be able to challenge the incumbents, whose ownership of national telephone networks gives them a huge advantage over their competitors. Skype is the result. So how can the incumbents respond? Some are rushing to launch their own internet-telephony services, but most are trapped in the monopolist mindset. Mr Zennstrom recalls their attempts in the early 1990s to establish fee-based proprietary e-mail services, in effect clinging to the old idea of the telegram. Such services were wiped out by internet-based e-mail, which was free. The same, he believes, will now happen to telephony.

Another lesson from history

These are all convincing arguments. Mr Zennstrom clearly has long-term trends in his favour. But another historical analogy gives cause for concern. The fate of KaZaA suggests that Skype will do well, at least for a while. But it also casts a shadow over its future. KaZaA declined in popularity (from 90% of all file-swapping traffic to 20% over the past year, according to one estimate) because its users were being sued by the music industry, but also because it was a proprietary standard. Rival file-sharing networks, based on open standards, are now in the ascendant. The same criticism is being levelled at Skype, which is so far incompatible with a standard (called SIP) used by rival internet-telephony operators. As with KaZaA, it may be that Mr Zennstrom has correctly identified an important trend, but that the software he has written to exploit it will not ultimately prevail. If so, he and Mr Friis will have to find another industry that is ripe for disruption using peer-to-peer technology. If you are a chief executive in a stodgy, old-fashioned industry, watch out.

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Electricité de France

A very big French turn-off

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AFP

Under pressure from the European Union to liberalise energy markets, the French government wants to part-privatise Electricité de France, the world's biggest utility. Should investors buy?

When France's centre-right government announced in 2002 its intention to part-privatise Electricité de France (EDF), the giant state-owned electricity group, its task was never going to be easy. But the government and the company were unprepared for just how hard it would turn out to be. In recent weeks EDF's workers have taken to the streets in protest against the passing of a bill, soon to be enacted, that paves the way for part-privatisation. As well as causing carefully targeted blackouts, including of the private homes of government ministers, they have restored supply to consumers disconnected for non-payment.

The partial sell-off of EDF had been expected to take place this year, but has now been postponed. The most sensitive feature of the bill is that it changes the status of EDF from a public enterprise, under which it is exempt from French bankruptcy laws, into a limited company governed by ordinary company law. This will remove the state's de facto guarantee of EDF's debts, to which Europe's competition authorities had objected because it amounted to illegal state aid.

The guarantee is important because EDF's balance sheet is under strain: its net debts are around €24 billion ($30 billion) and exceed its shareholders' funds. The imminent removal of the state guarantee has prompted credit-rating agencies to downgrade EDF's debt and to pay closer attention to its financial performance.

All the more so because of another change: from July 1st, EDF is no longer a protected monopoly at home (see article). While some European electricity markets (Britain's, for example) have been fully open to competition since the late 1990s, France has dragged its heels on liberalisation. But now all non-residential customers in France, representing around 70% of the market, are free to choose energy suppliers. Freedom for domestic users will follow in 2007.

EDF is not being broken up into separate generation, transmission and distribution and supply businesses. In theory the generation market is open to competition. However, there is over-capacity, EDF has a near monopoly and its electricity is produced mostly by low-marginal-cost nuclear-power stations. EDF will also retain France's grid, which distributes electricity.

EDF's supply business—where it connects directly to customers—will feel the bite of competition. Really big users of electricity have been free to choose suppliers since 2000. EDF's market share for this category has fallen from over 95% to around 80%. Further opening of the market poses a real threat to this dominance, as it is supposed to do.

This challenge comes just when EDF needs money to shore up its over-indebted balance sheet (François Roussely, chairman and chief executive since 1998, prefers to call EDF "under-capitalised"). The French government's coffers are too empty to afford a big capital injection, so part-privatisation seems inevitable. But how attractive would EDF be to outside investors?

The Economist has examined EDF's finances. What emerges is a picture of a group that has used some questionable accounting practices; that has never really made a profit; that has made imprudent use of funds set aside for nuclear decommissioning and waste-management; that lacks transparency over the level of its nuclear provisions; and that has indulged in a reckless and costly strategy of international expansion. (After many requests for an interview, EDF declined to answer written questions, but finally granted an interview by telephone on June 29th.)

The first thing that stands out about EDF's accounts is that the group appears to change accounting policies as often as Italy used to change governments. EDF's 2003 accounts were to have been the reference accounts for its part-privatisation. And in 2003 EDF adopted, but rather selectively, international accounting standards, which become compulsory for companies listed in the EU from 2005.

The effect of the selective adoption of new accounting standards was to increase the book value of EDF's shareholders' funds by €5.4 billion—an increase of nearly 40%—thereby, at the stroke of a pen, improving its over-stretched debt-to-equity ratio. Most of the increase came from a change in the method of depreciating the group's nuclear-power stations.

Generating numbers

EDF's 2003 accounts, as is the usual practice, include pro-forma results for 2002, prepared using the same accounting methods as those adopted in 2003. Such pro-forma results for a prior year usually help outsiders to make meaningful comparison with figures from the current year.

On the face of it, EDF's operating profits increased 33% on a pro-forma basis in 2003. However, in 2003 EDF extended the estimated life of its nuclear-power stations from 30 to 40 years, thereby reducing considerably its annual charge for depreciation. EDF's pro-forma results for 2002 do not reflect this life extension, on the grounds that it is a change in an accounting estimate as opposed to accounting method—a distinction that many people will not notice or understand. This decision, combined with a one-off gain of €534m from a physical inventory of EDF's assets, produced the whole of the increase in EDF's operating profits in 2003, which were €6.83 billion, compared with a pro-forma €5.15 billion in 2002.

This increase is dwarfed by one significant omission in EDF's adoption of the international accounting standards: the standard on employee benefits. Most of EDF's employees in France—it has about 112,000—are members of a generous pay-as-you-go pension scheme for utility employees. Currently the scheme is financed by employees' contributions, and EDF is on the hook for an annual (and growing) shortfall—€2.04 billion in 2003.

Grid numbers

EDF profit by region after tax, 2003, €m

France	1,480
Britain	296
Germany	-612
Rest of Europe	86
Latin America	-865
EDF trading	143
Other	329
Total	857
Shareholders' funds*	€18.9bn
Net debt*	€24.0bn

*As of December 31st 2003

Sources: EDF; company accounts

Adoption of the international accounting standard for employee benefits would have required EDF to make a provision in its balance sheet for pension obligations accrued to date. So how big are the liabilities? EDF's accounts do not even include this basic information, an omission that led EDF's auditors to qualify their opinion on the accounts. The auditors say that the liabilities are larger than the firm's shareholders' funds of €18.9 billion; a French parliamentary report, published last year, put the figure at €50 billion. With these gigantic liabilities on its balance sheet, EDF would have been technically insolvent.

So what will the new law do? It does not affect EDF employees' generous pension entitlements, but

reforms the funding and legal status of the pension scheme. From next January, France's general social security scheme will pay basic pensions to EDF's retired employees, although EDF will have to make a big one-off cash payment that is still being negotiated; future rights to additional benefits remain the responsibility of EDF. In effect, EDF has been freed from most of its legacy pension obligations; billions of euros in pension costs will now pass through the state's, rather than its, books. However, if EDF's past accounts had reflected these costs, the firm would never have shown a profit.

Even provisions that have been made on EDF's balance sheet do not tell the full story. EDF produces more nuclear power than any other company. Major costs for EDF are decommissioning the power stations at the end of their lives, the reprocessing of nuclear fuel and the removal and storage of radioactive waste.

Under accounting rules, estimates of these costs are added to the capital cost of a nuclear-power station in a company's balance sheet. As these costs will be incurred (mostly many) decades into the future, they are discounted to take account of the time-value of money. Corresponding provisions are set up in the balance sheet, and these increase each year to reflect the unwinding of the discount. The sums involved at EDF are huge: total nuclear provisions amounted to €26.8 billion at the end of 2003, even on a discounted basis.

Electricity consumers in France pay a specific charge to fund these costs. However, EDF does not put this money into a separate external pot to meet the future costs. Rather, it has been, and remains, able to use it to fund its business and to buy up competitors. The theory is that such investments will generate returns sufficient to fund the nuclear liabilities.

This is legal; whether it is prudent is another matter. It is analogous to a company investing employee pension contributions in its own business rather than establishing a ring-fenced fund with a separate legal personality—if the company disappears, so do the employees' pensions. Because nuclear decommissioning takes place over a very long time-scale, a company, such as EDF, without an external segregated fund to pay for decommissioning, is making a bold prediction of its existence and solvency for decades to come.

In other countries, such as America, Spain and Sweden, consumers' contributions are paid into an independent segregated fund to which the company has no (or very limited) access. But Germany, another big producer of nuclear power, also does not require segregated funds. This means that EDF, and E.ON and RWE, Germany's two biggest producers of nuclear power, have a competitive advantage over both nuclear and non-nuclear rivals.

This subject has been much debated in Europe. Two years ago on its first reading of a planned directive on electricity liberalisation, the European parliament passed an amendment that would have required legal separation (with no access by companies) of decommissioning or waste-management funds. However, the European Commission rejected the amendment, claiming it agreed on the importance of the issue but that a specific directive would be more appropriate.

When the matter was addressed, it was in the annex of a directive on nuclear safety, and there remained a loophole that would allow companies to continue to manage the funds “if exceptional and duly justified reasons make such a legal separation impossible”. Further wrangling followed. According to Derek Taylor, the commission's head of nuclear safety, Germany led resistance to the segregation of funds, closely followed by France.

A balancing act

There is no way of telling from EDF's accounts how much has been collected from consumers and “siphoned out” of the decommissioning and waste-management pot. However, if EDF had been required to segregate these funds, its borrowings would certainly be many billions higher than they are. “Without decommissioning funds, EDF would be almost bankrupt,” says Claude Turmes, rapporteur for the European parliament on electricity liberalisation. “I can't prove that I am right; EDF can't prove that I am wrong.”

There is also huge uncertainty over the size of EDF's nuclear provision, which comprises €12.1 billion for decommissioning costs and €14.7 billion for reprocessing and waste-management costs. For a start, EDF's way of estimating decommissioning costs seems rather arbitrary. They are calculated as 15% of the cost of a nuclear-power station, as recommended by a French government commission in 1979. In

fact, no nuclear reactor of the size run by EDF has ever been decommissioned.

And costs which stretch many decades into the future are subject to all kind of uncertainty, including the rate of inflation, discount rate, timing of the cashflows, change in statutory and environmental regulations and so on. EDF's auditors draw attention to this in their audit report. In its accounts, EDF gives scant detail of the assumptions used to calculate the provisions and no disclosure is made of the costs on an undiscounted basis.

In addition, decommissioning costs are susceptible to manipulation by being “discounted away” through the simple expedient of postponing part of the process. Even the extension of the operating life of EDF's nuclear-power stations by just ten years in 2003 reduced its decommissioning liabilities on a discounted basis by €2.3 billion. EDF insists that its provisioning policy is prudent and conservative, and that it has put aside €2 billion in its books for nuclear decommissioning costs.

A French champion?

Energy liberalisation in Europe unleashed a wave of mergers and acquisitions in the electricity industry. The value of such deals grew from €3.5 billion in 1999 to a peak of €42.7 billion in 2001. The share prices of utilities rocketed. E.ON and RWE, with access to their nuclear-decommissioning funds, were involved in €47.5 billion of deals between 2000 and 2002.

EDF joined the frenzy. Since 1998 it has expanded aggressively into other European countries, including Britain, Germany, Spain and Italy. In 2003, more than one-quarter of EDF's consolidated sales came from companies it owned in Europe, compared with just 10% in 1998.

AFP

Hands off my EDF!

So how wisely has EDF spent its money? One clue is that EDF's international operations in Europe and Latin America made a combined post-tax loss of €1.1 billion in 2003—though this did include big restructuring costs for loss-making subsidiaries in Germany and Brazil.

Another clue can be found in a scathing report published last year by a French parliamentary commission of inquiry, chaired by Philippe Douste-Blazy, now minister for health, into the management of state-owned companies. The report strongly criticises Mr Roussely's chairmanship. For some of EDF's big deals, proper procedures—such as informing the board or the state official who was supposed to agree to them—were not followed. The commission of inquiry had “serious reservations” about EDF's international expansion plans: there were no strict criteria either for the necessary return on investment; the funding of deals remained “vague”; there was no assessment of the impact of deals on the group's indebtedness; and so on.

Some deals are singled out. For instance, EDF showed “real and surprising imprudence”, according to the report, when it gained control of Edenor, an Argentine electricity company, in 2001. But one deal that has landed EDF with contingent liabilities of €10 billion, receives the most scathing criticism. The report says that EDF took risks which were “certainly excessive” when it opportunistically bought a stake in Montedison, a publicly quoted and heavily indebted conglomerate that controlled Edison, Italy's second-largest utility and EDF's real target.

In the first three weeks of May 2001, EDF snapped up 20% of Montedison at a cost of €1.1 billion, a 40% premium to Montedison's share price at the beginning of 2001. Rather than getting prior approval from the French Treasury to go above 3% as it was supposed to do, EDF informed the Treasury only after its stake had reached 11%. Mr Roussely gave an explanation for this sequence of events that the report describes as “far from being satisfactory”.

When EDF revealed the size of its stake under Italian stock-exchange rules, the Italian government immediately rushed through a decree, since converted into law, claiming that the EDF was trying unfairly to enter Italy's deregulated market while the French market remained mostly closed. This law, aimed directly at EDF, restricts state-controlled firms to 2% of the voting rights of Italian companies in the electricity and gas sectors. So, in its desperation to break into the Italian electricity market, EDF paid a very fancy price for a stake that gave it little say.

To salvage some value, EDF was forced into the arms of Fiat and others to form Ital-energia, a vehicle created to mount a successful bid for Montedison. In exchange for its stake in Montedison, which was renamed Edison in 2002, EDF received an 18% stake in Italenergia, and Fenice, an energy-services firm, from Fiat. Fenice was valued at €500m at the date of the exchange, but was written down months later in EDF's books to €43m.

In 2002, desperate for eventual control at any price, EDF granted options to other Italenergia shareholders to sell it the remaining 82% for €3.7 billion in early 2005. If forced to buy these shares, which is likely, EDF would become Edison's controlling shareholder (with 62% of its equity). Under Italian law, EDF would then have to make an offer for the 18.5% of Edison's shares in public hands—a cost of €1.1 billion at current share prices. So EDF is facing a cash outlay of nearly €5 billion in 2005 just for this deal.

If this happens, EDF would end up paying €5.4 billion for its equity stake in Edison, which made pre-tax profits in 2003 of a mere €156m on its core activities. And EDF would still have only 2% of Edison's votes. In its 2003 accounts, EDF had to make a provision of €855m, representing its estimate of the amount it would be over-paying Italenergia shareholders.

If EDF controls Italenergia and thus Edison, it will also have to consolidate the debts of these firms. Italenergia has debts of €1.1 billion and Edison, despite selling non-core businesses in 2003, still has net debts of €4.1 billion. So, including the cash outlay for the shares, the total extra debt on EDF's balance sheet would be €10 billion.

Small wonder, then, that there is growing criticism in France of Mr Roussely's management of EDF. But there is also a creeping realisation that France faces a much bigger problem in trying to privatise its electricity giant than was once thought. Because of the extreme nature of its financial uncertainties, EDF cannot easily offer attractive terms to potential buyers of its shares. Indeed, its future need for equity capital is unmeasurable. Investors with legal liability—pension or mutual funds, for example—may not be able to buy such risky shares unless they come with some form of guarantee. Add in the political difficulties of part-privatisation, and it begins to look as if the project is unfeasible.

Rather than trying to raise new capital, EDF would do better to accept that it is unprivatisable and seek instead to sell some of its overseas businesses. Its British assets would fetch billions. That would be hard for French pride to swallow. But a controversial sell-off that could go horribly wrong? That would be harder still.

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Monetary policy

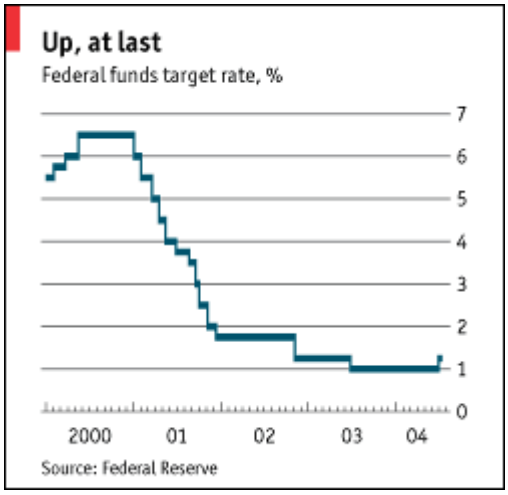
Off the bottom

Jul 1st 2004
From The Economist print edition

As expected, the Federal Reserve raised interest rates this week. Can it keep doing so without upsetting America's financial markets or its economy?

WHEN the Federal Reserve put up America's short-term interest rates on June 30th, by a quarter of a percentage point to 1.25%, financial markets shrugged rather than trembled. Rarely has a central bank's decision been so long and so accurately anticipated. The Fed's move lifts America's short-term rates off their floor-scraping low of 1% (see chart), the cheapest that money had been since the late 1950s.

Just over four years ago, as the great technology boom was ending, short-term rates stood at 6.5%. But as signs of the global downturn emerged, the Fed began cutting rates aggressively. Now the era of ultra-cheap money is drawing to a close, and not only in America. Other central banks have raised rates already. The Bank of England has put up rates by a percentage point, to 4.5%, since November; Australia's central bank has raised its base rate by the same amount, to 5.25%, in the past two years. Both sets of increases seem to have been driven as much by worries over booming asset prices, especially housing, as by incipient consumer-price inflation.



Nevertheless, it may be a while before official short-term rates increase in Japan and the euro area. Despite signs that deflation in Japan may be abating, few expect the Bank of Japan to end its zero-interest-rate policy in the near future. On July 1st, the European Central Bank (ECB) kept its main short-term rate at 2%.

A couple of months ago, it seemed that the ECB might cut rates, in response to continuing sluggishness in the euro area, especially in Germany. But that never happened. Indeed, with inflation at 2.4% in June, almost half a point more than the ECB says it will tolerate, an increase now looks much more likely. However, the central bank's recent attempts to explain its policy publicly have left analysts confused. Its newish president, Jean-Claude Trichet, was due to have another go after this week's rate-setting meeting (and after *The Economist* went to press).

Despite the reputation for oblique language enjoyed by Alan Greenspan, the Fed's chairman, he has managed to make his intentions clear. Just as well: last year, he confused the bond market by sending

mixed signals about the Fed's plans for interest rates. Worse, in the previous tightening cycle, in 1994, the Fed wrong-footed the bond market completely, sending prices crashing. No wonder the central bank has prepared the ground more carefully this time, and will no doubt continue to do so if and when it raises rates further. And given the amount of debt Americans now carry, there is a risk that a rapid, unexpected rise in rates could damage asset prices and consumer spending, and hence the economy (see article).

Step by step

So this week's rate increase is intended to be the first stage of a “measured” monetary tightening. The case for raising rates is plain from recent data. Job growth has quickened, and spare capacity is beginning to shrink. Consumer prices in America rose by 3.1% in the year to May, up from 2.1% a year ago. “Core” consumer-price inflation, which excludes the volatile prices of energy and food, climbed from 1% in December to 1.8% in May. By historical standards, this is tame—implying there is no need to tighten policy in a hurry.

Even so, has the Fed been too slow to act? America has enjoyed an enormous monetary stimulus in the past few years (and a giant fiscal boost too). In real terms, American interest rates are negative. They would remain so even if the Fed were to push up rates as far as 3%. With the economy motoring and inflation already showing signs of picking up, perhaps rates will have to be increased faster and by more than markets expect.

One troubling recent sign came with the publication late last week of revised figures for American inflation and economic growth in the first quarter of 2004. The personal consumption expenditure deflator, a measure of inflation that is widely watched (and believed to be a favourite of Mr Greenspan's), rose by 2.0% at an annualised rate. GDP growth was revised down to 3.9%, from the previous estimate of 4.4%. If that is a sign of things to come, markets' confidence in the Fed's strategy will be shaken.

So far, however, bond markets have been calm, at least by the wretched standards of 1994. The strengthening economy and the expectation of rate increases have already produced a sell-off from the giddy levels of last summer. Then the yield on ten-year Treasuries dipped briefly to 3.1%. It peaked recently at almost 4.9%, and on June 30th, just after the rate increase, stood at just under 4.6%. The spreads on corporate bonds, especially the riskier ones, and those of emerging-market borrowers have widened in recent months. All this hurts bondholders, of course, and as short-term rates rise they may suffer more. Still, thanks to Mr Greenspan's choreography, banks, at least, like to think that they have already pared down their riskier positions. The next few quarters will put this claim to the test (see article).

And what of the dollar? If American interest rates rise relative to those in the euro area, Japan and perhaps even Britain, the dollar will seem a more attractive bet than it is at present. That ought to lead to a stronger dollar against other currencies. Indeed, in recent months expectations that the greenback would plummet have mostly faded. The dollar has risen by 6% against the euro since the beginning of the year.

And yet there are also strong forces pushing the other way. America's current-account deficit hit a new record high in the first quarter, reaching 5.1% of GDP. The goods and services trade deficit keeps rising, thanks to America's insatiable appetite for imports. Whatever the yield on American assets, the dollar will be hostage to these imbalances, as well as to the response of Asian central banks. Any interest-rate-inspired dollar rally may therefore be short-lived.

Most brokers' forecasts predict that America's base interest rate will be just over 2% by the end of this year, and perhaps 4% by the end of next. But if inflation in America rises faster than anyone today expects, the Fed's current gradualist approach will turn into something altogether more hawkish. Indeed, Fed officials have been insisting that they are willing to step harder on the brakes if required. Financial markets, not to mention all those indebted Americans, must be hoping that they do not have to.

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About sponsorship

Interest rates and American banks

Tighter times ahead

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America's banks have thrived on cheap money. What now?

WHO gained most from the bursting of the technology bubble four years ago? Arguably, America's banks did. As the Federal Reserve shaved interest rates again and again, banks lent enthusiastically, especially to American households eager to remortgage their homes at cheaper rates. The rewards have been ample. According to the Federal Deposit Insurance Corporation, which guarantees deposits at American banks and savings institutions, the profits of the companies it oversees reached $31.9 billion in the first quarter of this year, the fifth quarterly record in a row. Financial firms now account for over a third of all American companies' domestic profits, according to Smithers & Co, a consultancy.

So a certain nervousness has surrounded bank shares in anticipation of this week's increase in interest rates. The jitters have been most obvious at Washington Mutual (WaMu), one of America's three leading mortgage lenders. The Seattle bank has been a star in the past few years, building itself into the country's seventh-biggest bank by opening new shop-style branches, peopled by chino-clad staff, in several cities. On June 28th it said that rising interest rates will knock this year's profits back to at least 20% below what was previously expected. Analysts grumbled that rate increases were a poor excuse—hadn't everyone seen them coming?—and wondered whether WaMu might now be a takeover candidate.

Will the industry as a whole suffer? Broadly speaking, banks make money in two ways. They are paid for taking on risk—mainly, the risk of movements in interest rates and the risk that borrowers fail to repay loans. Increasingly, they also earn fees for being the middlemen in capital-market transactions (structuring derivatives, share and bond offerings, and so forth). Fees now make up about 40% of profits.

On the plus side, says Sung Won Sohn, chief economist of Wells Fargo, America's fourth-largest bank and another top mortgage lender, “interest rates are going up for a good reason—the economy is growing and that helps banks.” The idea is that rising personal income, fatter corporate profits and a robust stockmarket will boost deposit-taking, lending and fee income.

Moreover, rising rates should help banks earn more from current (checking) accounts, particularly those that earn no interest, because banks can now invest this money in higher-yielding government bonds. Simon Harris of Mercer Oliver Wyman, a consulting firm, reckons that some $1.1 trillion, or one-fifth of all deposits at American banks, are in non-interest-bearing accounts.

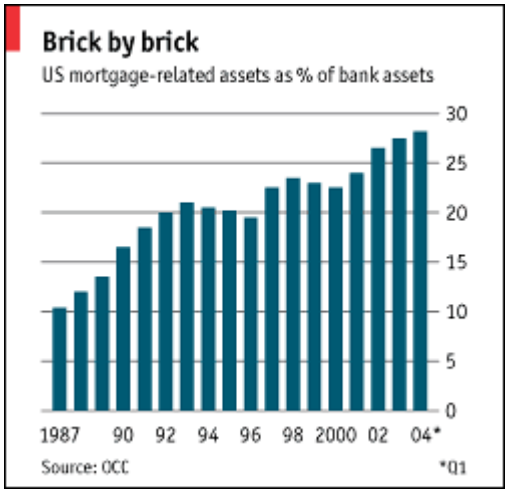
On the other hand, higher rates are likely to disrupt a steady source of income in the past few years: the taking of short-term deposits and relending them longer-term at higher rates to companies, the government and households. As long as the yield curve, the difference between long-term and short-term interest rates, is positive, banks can make money. In the past four years of low rates, this gap has been wide and banks have made a killing. With short-term rates rising, however, the yield curve and banks' profits may flatten.

To make matters worse, the value of loans and securities held by banks falls as interest rates rise. The Office of the Comptroller of the Currency (OCC), one of America's bank regulators, says securities held by banks are close to 20% of assets, a record. Already, their value has deteriorated as bond yields have risen.

Safe as houses

Many of these depreciating securities consist of mortgage loans

and mortgage-backed securities (known collectively as mortgage-related assets, or MRAs). Indeed, regulators' biggest worry is the reliance of the banking industry on the mortgage market. According to the OCC, MRAs now make up 28% of American commercial banks' assets (see chart), thanks to a housing boom fed by cheap mortgages. A recent analysis by the OCC found that a rise in interest rates of two percentage points would cause equity capital at 101 banks to fall by at least a quarter. At 18 banks, it would fall by half or more.



As WaMu's warning indicates, rising rates are likely to stifle the lucrative business of mortgage writing and refinancing. According to the Mortgage Bankers Association, refinancing has fallen by 71% since March, when markets started to expect a rate hike, and by 85% since its peak in May 2003. And higher rates could spark credit defaults if Americans struggle with higher interest costs. The proportion of households' income spent on servicing debts did not budge as interest rates dropped, according to the OCC. It stayed at 13.5%, a record, compared with 11% in the early 1990s. Especially troubling is the rapid growth in the use of home-equity credit lines, which has doubled in the past four years to over $1 trillion, because these, unlike most mortgages, carry variable interest rates, according to David Wyss, chief economist of Standard & Poor's.

All this may sound frightening, but the banks have had time to prepare for higher rates. America's big banks have been rejigging their portfolios for a while in anticipation of the Fed's move. Securitisations of interest-rate sensitive mortgages, for example, have boomed in the past couple of months. WaMu sold some $14 billion-worth of fixed-rate securities in the first quarter of this year. “This not a shock,” says Mr Wyss. “Greenspan has been running around the country kicking banks in the shins to get them to unwind their positions.” For the most part, he thinks, they have done so—although some banks will be left behind.

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About sponsorship

Bank capital adequacy

Basel lite

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New banking rules are less precise than they look

ON JUNE 26th, the world's top central bankers put their seal of approval on Basel 2, a new capital-adequacy framework for banks, which is intended to come into force in stages from the end of 2006. The fruit of more than five years' work by a committee of leading bank supervisors, Basel 2 is supposed to relate banks' regulatory capital more closely to the perceived risks that they run. Yet the framework has become so protean that the central bankers might as well have stayed at home.

Do not despair, though: Basel 2's creators hope that this very flexibility will turn out to be its magic. Bank regulators, terrified of “regulatory capture”—having the wool pulled over their eyes by clever bankers—have ended up committing themselves to almost nothing. True, the number-crunching part of the framework contains lots of daunting and devilish ratios for credit risk (the chance that a debt might not be repaid or recovered) and operational risk (the chance that, say, a bank is clobbered with a large regulatory penalty). But these are less exact than they look: there is almost unlimited scope for these to be adjusted over the next few years.

Moreover, regulators are still haggling with bankers over many details, such as “double default”, the extra weight to be given to the risk that a provider of credit insurance might go bust as well as a borrower. Bankers claim this is negligible: regulators are not convinced.

To make matters less precise still, during negotiations with bank associations, regulators have been placing less weight on “pillar 1” and more on “pillar 2”—Basel-speak for supervisors' discretion—in order to overcome anomalies produced by the formulas in pillar 1. Each national banking system and each class of bank within it has a different track record of default and of recovering loan losses, and faces different operational and legal risks. The only way to deal with these inconsistencies is to allow regulators to adjust the rules. The framework allows for exactly that.

There is also a “pillar 3”: reliance on disclosure by banks and market reaction to it as a means of discipline. This too is already bearing an increasing weight. Banks have been under more pressure from rating agencies and from threats to their sources of funding than they have been from regulators to show that they are aligning themselves with Basel 2. A prime example is Germany's Landesbanks, wholesale, state-sector banks which in a year's time will lose their state guarantee for any new funds they raise. That deadline, and the anticipation of it by rating agencies and buyers of their bonds, has convinced them faster than any regulator that they needed to improve their capital ratios.

If there were no implicit or explicit guarantee, such as deposit insurance or a lender of last resort, the bank supervisors could let pillar 3, market discipline, do their job entirely. That is, or should be, the ultimate goal towards which this framework is moving.

However, there is a snag. Basel 2 is being translated into European law, to be applied to investment firms as well as banks throughout the European Union. Amendments to the Codified Banking Directive and the Capital Adequacy Directive should be drafted some time this month. It remains to be seen how much room will be given for flexible negotiation. The European Commission is trying to reduce the amount of discretion that each national supervisor is permitted under the Basel 2 framework. It will be a pity if the commission does not change its mind.

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Germany and Russian debt

Soviet solution

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A cash-strapped government finds a novel way of raising money

EPA

For Eichel, every little counts

HANS EICHEL, Germany's finance minister, has a hole in his budget. His plans to raise €10 billion ($12 billion) through privatisation this year have come to naught. Yet budget law forbids him to borrow more than he invests. So wizards at Deutsche Bank and Goldman Sachs have offered him a solution: monetise some of the official debt owed to Germany by Russia.

Russia owes Germany around €14 billion. Some of this was borrowed long ago by the Soviet Union, partly from the East German government. It was all rescheduled in 1999. Since then Russia has made most of its scheduled payments right on time.

Up to €5 billion in credit-linked notes of various types will be issued by Aries, a special-purpose vehicle. Investors will be offered slightly more than the return available from the main types of Russian sovereign debt. Russia's payments to Germany will be passed through Aries and used to service the bonds. If Russia delays payments by more than 60 days, the German government will have the option of buying the bonds back, paying 20% of their face value. On its showing since 1999, and even in the darkest days of the 1990s, Russia is fairly reliable: the few payment blips have lasted a month at worst. So plenty of investors see the notes as bringing highish yield at lowish risk. However, rating agencies disagree: both Standard & Poor's and Moody's regard them, like Russian sovereign debt, as below investment grade.

The securitising of bilateral government debt rescheduled jointly by the “Paris Club” of big creditor countries has never been done before. Even now, Germany will still hold the debt; it will merely pass on some of the credit risk. The Russians apparently have no objection to their debt being treated this way. Markets, however, disliked the deal, fearing that Russian paper will, in effect, be oversupplied.

For Mr Eichel this is a neat way of recouping quickly some of the taxpayers' money that was used to promote commerce with the former Soviet Union. But, his political opponents are asking, how much is he sacrificing to get the money now? Instead of keeping a steady annuity from the Russians, Germany is selling the cashflow at a discount. The exact terms of the Paris Club payments are not public, so it is not possible to know the maths, but the experts at Germany's finance ministry must presumably have done the sums. As for the Russian government, it might have noticed that buying the notes itself would provide it with a nice return—more, indeed, than it is paying out in interest on the same debt.

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Management change at Credit Suisse

The sack for Mack

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From The Economist print edition

After its near-death experience, an investment bank boots out its leader

TO MANY outsiders, a top investment bank looks like a wonderful place to work. The pay is lavish and there are perks galore. Many insiders are not so sure. The hours are crippling, there is always someone with a bigger bonus than yours, and the infighting can be brutal. Take Credit Suisse. After a torrid time in the testing markets of the past few years, the Swiss financial conglomerate has begun earning good money and recruiting people instead of sacking them. Maybe life had become too calm. On June 24th Credit Suisse dumped John Mack, its co-chief executive and head of Credit Suisse First Boston (CSFB), its investment-banking arm.

This being Wall Street, it was not Mr Mack's first such experience: one of the Street's best-known executives, he left Morgan Stanley in similar, involuntary circumstances in March 2001. Oswald Grübel, hitherto co-chief executive with Mr Mack, will become sole head of Credit Suisse. At CSFB, Mr Mack will be succeeded by Brady Dougan, who had, it is said, unwillingly been sent to Europe by Mr Mack earlier in the year. Mr Dougan is one of the last senior survivors from the leadership of Allen Wheat, who was replaced by Mr Mack in July 2001.

EPA

Mack the knifed

Mr Mack spent a lot of his time repairing what had gone wrong under Mr Wheat. The bank had gone in for all manner of risky proprietary trading. It made a name for itself in underwriting technology stocks in the bubble years—only for regulators to come knocking after the crash, wondering why some hot shares had been “spun” to favourite clients. Earlier this year Frank Quattrone, once its star banker in the field, was convicted of obstructing justice. The firm also made a disastrous acquisition, of Donaldson, Lufkin & Jenrette, another investment bank. Outside America, regulators from London to Delhi crawled over its books. It was kicked out of Japan. It caught a nasty cold in the Russian meltdown of 1998. Many employees made vast fortunes along the way, but CSFB and its reputation were left in tatters.

In fact, over the years CSFB has been peculiarly accident-prone. As First Boston, it was brought from near-bankruptcy to pre-eminence by a former Merrill Lynch executive named George Shinn. After he left in the mid-1980s to study literature, his successors had a knack of allowing great strengths to turn into disasters. Prowess in mergers, leveraged buyouts and then in public offerings of technology stocks, all showed promise and then spun out of control. Had it not been for the relationship with Credit Suisse, a Shinn legacy, the firm would have died long ago.

By the time Mr Mack arrived, CSFB suffered from four problems, any one of which was enough to kill a securities firm. Regulators had descended like locusts; although profits from tech-stock underwriting had disappeared, technology bankers enjoyed generous pay guarantees; employees were polarised in small, dysfunctional fiefs; and the financial markets were a shambles. Mr Mack spent a lot on legal talent and settlements to protect the firm, but he eliminated the most costly compensation contracts and got rid of more than 20% of the employees. He still kept enough clever people to make money for the investment bank.

Luck and judgment

Working in his favour was a wonderful market for fixed income. This and the cost cuts proved effective. In 2002 Credit Suisse lost SFr3.3 billion ($2.1 billion), largely thanks to CSFB and the group's insurance operations. There was serious concern that CSFB's woes would drag down the rest of the company. Last year, Credit Suisse earned SFr5 billion. It would make much more if its returns could be raised to the level of its competitors'.

Mr Mack apparently hoped to round off the revival of CSFB by finding a merger partner. It is easy to see why. With interest rates rising, the fixed-income markets will slow. Economic activity may be dampened too, which may weigh on equity markets. Investment banks' costs are once again threatening to rise, now that competition for employees has resumed: Mr Mack's economy drive notwithstanding, CSFB is being drawn in. Areas that look particularly good now, notably proprietary trading, are just the risky sort that Mr Mack tried to discourage. Yet the thought of a deal apparently proved unpalatable to Credit Suisse's Swiss-based board. The board may also have tired of Mr Mack's style, which leans more to New York blunt than Zurich polite. The announcement that his contract, which expires on July 12th, would not be renewed, seems to have come as a shock to CSFB's entire management in New York.

The bank says there will be no big purchases nor a sale of core operations. Still, it is likely to put Winterthur, its insurance subsidiary, on the market, having decided that there is no future in being in both banking and insurance. Proprietary trading will increase, as will trading in commodities. These are risky, but make pots of money for other banks. Activities that CSFB has done well in one region, such as mortgage trading in America, will be exported to Europe and Asia. There will be efforts at synergy between private banking and investment banking. If all this turns out to be a failure, Mr Mack's merger idea may have to be revived.

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Cotton in China

Soft landing?

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From The Economist print edition

AP

The trouble with commodity booms

CHINA, the world's biggest producer and consumer of cotton, looks set for a record harvest this year. Even so, this will not be enough to satisfy soaring demand, which in April pushed up cotton imports to 186% more than in the same month last year. How long will China maintain its prodigious appetite for cotton, and farmers their enthusiasm for growing it?

Since 1999, the Chinese government has relaxed its control of the cotton industry. Farmers no longer have to sell part of their crop at set prices and no longer have the certainty of guaranteed purchases by the state. The government has given up its monopoly over purchasing and distribution. As a result, private traders have surged into the market (though imports and exports remain under state control). And textile manufacturing, once dominated by the state, has become a fiercely competitive industry, with many mills in private hands.

For those trying to forecast supply and demand, China's introduction of market forces has not made life any easier. Like much of the half-reformed economy, the cotton sector is wont to act irrationally. Consider demand, which stems almost entirely from the textile industry. By January 1st 2005, under a World Trade Organisation agreement, quotas that distort international trade in textiles and clothing are supposed to be phased out. Sensing an opportunity to boost sales enormously in foreign markets, investors have poured money into textile factories, despite a ballooning excess of capacity. Last year investment in the sector grew by 74%. State-owned banks have fuelled the boom with easy loans.

On the supply side there has also been a stampede. Mainly as a result of rain damage to last year's crop and the growth in milling capacity, cotton prices soared. Between September and November last year they rose by 46% to 19,000 yuan ($2,290) a tonne. Farmers rushed to expand their cotton acreage. In the current marketing year (August to July), the planted area is expected to increase by more than 12%, after a 22% expansion last year. The China Cotton Association (CCA), a government-backed industry group, predicts that output this year will be up by 23%.

This burgeoning supply is helping to push prices down again. So is government policy. In recent months the government has expanded its cotton import quotas to try to meet demand with cheaper foreign cotton. And in May, as part of its campaign to curb inflation, the government added the textile sector to a list of industries to which bank loans would be curbed. By the middle of this month, with a bumper

harvest in prospect, cotton prices were almost back to last September's level.

In theory falling prices should be good news for textile producers. The earlier price surge had erased the profit margins of many and forced some to suspend production or close entirely. But a group of 48 cotton-related enterprises complained in a petition published recently on the CCA's website that the picture remained gloomy. “Cotton prices are still falling rapidly, and this has created a vicious circle,” it said; worse, in the expectation of a further drop, processors were reluctant to buy cotton and were thereby disrupting the entire production chain. It gave warning that the price plunge could damage social and political stability.

In an effort to reduce these ups and downs, the country has decided to have another go at futures trading—an experiment it had long resisted because of fears of speculation and irregularities in the market. On June 1st, small-scale trading of cotton futures, with no foreigners allowed, was launched in the central city of Zhengzhou. Officials talk of China's futures market one day becoming a crucial part of the global cotton trade. That day, though, is clearly far off.

Despite the swings in China's market, Jeff Coey of Cotton Council International, an American export-promotion group, says that over the long term demand will grow, as Chinese textile manufacturers (and their foreign counterparts, whose factories currently produce 40% of China's textile exports) seek to boost overseas sales. Domestic cotton production, restrained by government efforts to turn more land over to grain, will continue to fall short of demand. “They're going to have to rely more and more on imports,” Mr Coey predicts.

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Economics focus

Inflated expectations

Jul 1st 2004
From The Economist print edition

A new paper questions whether inflation will really turn out to be America's main economic problem

HOW much further will the Federal Reserve have to raise rates? This week it added some flesh to America's skeletal interest rates when it raised them by a quarter of a point, to 1.25%. The market predicts that rates will gradually rise to 4% or thereabouts by the end of next year. The economy is skipping along nicely and rates, after all, are still very low. But the market is also starting to fret about inflationary pressures. Indeed, some—this newspaper included—think that the Fed has been too sluggish: with monetary policy still loose, inflation is likely to creep upwards. But the outlook for interest rates will be quite different if inflation is not America's biggest economic problem. A fascinating paper, “Dicing with Debt”, by Stephen King, the head economist at HSBC, a big British bank, explains why it might not be.

Mr King's starting-point is that the Fed and other central banks need not have been as worried as they were about the threat of deflation. Certainly, debt deflation is a particularly malign economic beast, which emerges when people curb their spending in an effort to pay off their debts. Those very spending cuts cause prices to drop, and force up the real value of debts, creating a vicious spiral. As the experience of America in the 1930s and Japan in the 1990s shows, central banks can do little about this, because they cannot set interest rates lower than zero. It was fears of just this sort that caused the Fed to slash interest rates 13 times, to anorexic dimensions.

Most commentators have cheered Alan Greenspan and his colleagues at the Fed for being so aggressive in warding off the deflationary threat caused by huge corporate debts and the popping of the stockmarket bubble. After all, one of the shallowest recessions on record was followed by a strong recovery in which bumper profits enabled overly indebted companies to reduce their debts to more manageable levels.

Mr King is not among those cheerleaders. He argues that the Fed was wrong to cut interest rates so much, because much of the deflationary pressure was of an altogether more benign sort: a reduction in overall prices caused by rapid technological change, improvements in the terms of trade and other factors. Britain had long periods of “good” deflation in the late 18th and 19th centuries, when nominal interest rates and growth were both strong. In recent years, argues Mr King, there has again been deflation of just that sort, and for similar reasons. Technological change and the integration of China, and increasingly India, into the global economy have pushed down the price of traded goods in America, thus pushing up real incomes. “And, because of these real gains, any rise in real debt levels will not be a source of potential ongoing instability,” writes Mr King. Alas, because the Fed's perceptions of deflation have been coloured by the experiences of America in the Depression and Japan in its lost decade, it reacted by reducing interest rates sharply, a response that is more likely to bring about the debt deflation it most feared.

High real growth—so long as deflation is of the good sort—requires high real interest rates. If rates are too low, people borrow too much and spend it badly: what Mr King calls “happy investment rather than good investment”. For a given level of nominal interest rates, a fall in prices will deliver the appropriate level of real interest rates. But by cutting nominal rates to prevent deflation, the Fed has reduced the real rate of interest too much.

Evidence that this has been the case comes in two forms. The first is that borrowing has ballooned in America in recent years. Any reduction in the indebtedness of American firms (under immense pressure from the capital markets) has been more than matched by borrowing by consumers and the government. Even though interest rates have been so low, the proportion of household income that is spent on

servicing debts is at record highs. The government's stock of debt has been rising rapidly: this year, its budget deficit is likely to be 4.7% of GDP. This is why America's current-account deficit has been rising: as a country, America borrows too much.

The trouble with cheap money

Here is where the second piece of evidence comes in: what Americans spend their money on. If money is too cheap, then rates of return will fall, companies will tend to use capital rather than labour, and people will spend money on riskier assets; on things that have little to do with underlying economic growth; and on things that are in short supply. As it happens, this is a decent description of America in the past few years. Companies have been slow to hire workers even as the economy has bounded along; and workers' share of national income is very low. The low cost of capital has, moreover, encouraged speculation in risky assets, such as emerging markets, or—closer to home, as it were—property. And, yes, with all that money sloshing about, it has also pushed up inflation a bit.

When economic growth is fuelled by asset prices and debt, pushing up interest rates is likely to have an effect only in so far as it affects expectations about the prices of those assets. This creates huge problems for policymakers. Will a small rise in rates have a small effect (because, say, expectations about further rises in house prices are so entrenched)? Or a big one (because people expect more rate rises)? Whatever the answers to these questions in the short term, at some point, says Mr King, attitudes towards asset prices and debt will have to change.

There is thus a distinct danger that by pushing real interest rates back to where they should have been in the first place, monetary tightening will reveal the economic recovery to have been more fragile than most think—and threaten a hard landing and the malign sort of deflation that the Fed was so keen to avoid. This could even mean that rates need to fall next year, not rise. And with rates so low and budget deficits already high, America's economic armoury is much depleted.

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Coding theory

Not the usual channels

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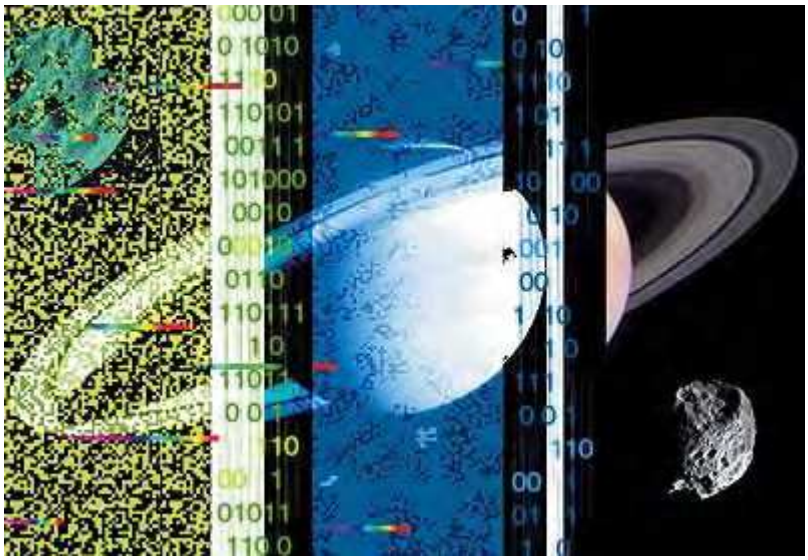
From The Economist print edition



How to transmit information reliably

ON JULY 1st, a spacecraft called *Cassini* went into orbit around Saturn—the first probe to visit the planet since 1981. While the rockets that got it there are surely impressive, just as impressive, and much neglected, is the communications technology that will allow it to transmit its pictures millions of kilometres back to Earth with antennae that use little more power than a light-bulb.

To perform this transmission through the noisy vacuum of space, *Cassini* employs what are known as error-correcting codes. These contain internal tricks that allow the receiver to determine whether what has been received is accurate and, ideally, to reconstruct the correct version if it is not.

Such codes go back to 1948, the year when Claude Shannon, universally regarded as the father of coding theory, published a paper which showed the maximum theoretical rate at which information can be transmitted without error. But it is only recently that real codes have started to approach Shannon's theoretical limit. Those on *Cassini*, while powerful, still have some way to go, because the probe is limited to the technology available when it was built in the mid-1990s. But developments in coding theory made at the time *Cassini* was being assembled are now coming to fruition. As a result, as well as spacecraft, tomorrow's consumer-electronic devices, from mobile phones to high-definition televisions, will be able to receive and transmit data at something close to Shannon's limit.

Turbo coding, as the first of the new techniques to come on stream is known, was invented by Alain Glavieux and Claude Berrou, two researchers at the Ecole Nationale Supérieure des Télécommunications de Bretagne in Brest, France. It is now being deployed in third-generation (3G) mobile-telephone networks, and will allow wireless access from 3G phones to be over ten times faster than from an old-fashioned dial-up line.

Turbo-charged transmission

Turbo coding takes one of the techniques deployed on *Cassini*—known as convolution coding—and doubles it. Convolutional codes work by adding some of the bits (the ones and zeros of binary arithmetic) from a block of data, and transmitting that sum alongside the raw data. The decoder then works

backwards, to make sure the sums add up correctly. If they do not, it knows there has been a mistake and fiddles with the appropriate bits to try to correct the errors. Unfortunately, it does not always succeed.

What Dr Glavieux and Dr Berrou showed was that combining two convolutional codes would yield a dramatic improvement in performance—one that would go almost all the way to the Shannon limit. To do this, you have to shuffle the bits in each block of data at random. Each block is then broadcast twice—once unshuffled and once shuffled. One convolutional decoder works on the unshuffled data, and the other on the shuffled data. The shuffling means that an error which affects one block will not affect the other at the same place in the sequence.

If the two decoders disagree about a particular bit in the message because transmission noise has introduced errors, they consult one another by feeding their “opinions” about the error to each other, along with a measure of how confident each is about its opinion. Each decoder then uses the other's input to make a decision, and the process is repeated until they agree with each other.

This feedback loop has proved to be effective at making almost error-free transmissions, so long as each block of transmitted data is fairly long. This requirement for long blocks of data means that turbo codes are not very useful for applications that require almost no delays but transmit a fairly small number of bits—voice communications, for example. But they are ideal for data-rich applications such as wireless broadband.

Or almost ideal. For another coding technology is being touted to replace them before they have even been properly deployed. Low-density parity check (LDPC) codes are actually an old trick. They were invented by Robert Gallager, then a doctoral student at the Massachusetts Institute of Technology, in 1960. But, because the computers of the time were not powerful enough to take advantage of their benefits, these codes were largely forgotten until 1994—when three different groups of researchers rediscovered them.

LDPC codes also work on large blocks of data, but each batch is then encoded using a mathematical technique known as matrix algebra. This involves “multiplying” a block of bits by an array of different bits known as a matrix, and then transmitting the resulting bits.

The matrices used in LDPC coding are a type known as sparse matrices, in which almost all of the entries in the array are zero, rather than one. Because the few non-zero entries in a sparse array tend to be far apart, the process of matrix multiplication means that the resulting blocks of code end up looking different from one another, even if the starting data are similar. This, in turn, means that LDPC codes can tolerate large numbers of errors and still detect where the mistakes are. Furthermore, according to David MacKay of Cambridge University, who is one of the pioneers of the new generation of LDPC codes, after a few mathematical tweaks dreamt up in the late 1990s, these codes now outperform turbo codes, and are computationally simpler to implement.

This, according to Dr MacKay, is why they have been adopted in the next-generation standard for satellite television, which is being hammered out by the regulators at the European Telecommunications Standards Institute over the next few months. They are also being incorporated into standards for so-called 4G mobile telephones, which will, if all goes well, be introduced around 2010. These phones would be able to handle as many as a billion bits a second. At that rate it would only take a few seconds to download an entire movie. Perhaps the next probe to go to Saturn will send back live video to the world's mobile phones.

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Traffic jams

Adapting to road conditions

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From The Economist print edition

The spread of adaptive cruise control may bring an unexpected bonus

Adapt or die—of boredom

SITTING in stationary traffic is, at best, a Zen experience. Drivers mired in a jam learn to cede control to the powers that be, becoming at one with the universe as they breathe in the mind-numbing fumes all around. At worst, it is an ongoing battle for sanity. But now, according to several groups of researchers in America and Germany, there is something that drivers can do to take back control over the roads. Get adaptive cruise control. And, of course, use it.

Adaptive cruise control (ACC), as its name suggests, is a modified version of traditional cruise control. It employs radar to monitor the road ahead of a vehicle, automatically adjusting that vehicle's speed to maintain a safe distance from the one in front. This is safer than manual driving because it reduces the system's reaction time from nearly a second (human) to practically instantaneous (machine), thus helping to forestall shunts. But ACC may have a useful side-effect, arising from the fact that another effect of slow human reaction times is to produce traffic jams on apparently open roads.

Such jams start when a car slows suddenly to allow, for example, another vehicle to enter the traffic stream. Slow reaction times mean that instead of responding smoothly, the drivers behind such a vehicle often end up slamming on the brakes. That slamming propagates backwards, and before long the traffic is at a standstill. So it makes sense that ACC would reduce not only collisions, but also congestion. What is unexpected is how few vehicles need to have it operating for all to benefit. As Craig Davis of the University of Michigan reports in *Physical Review E*, only 20% of cars need to employ ACC in order to prevent completely those jams that are caused by a slow lead car on a high-speed, single-lane road. According to Dr Davis's computer model, even a rate of use of ACC as low as 13% can improve the flow of traffic significantly.

ACC is not a panacea. Dr Davis got less promising results for more complex road conditions, particularly those near junctions. And a similar model built by Boris Kerner, a researcher for DaimlerChrysler, in Stuttgart, Germany, indicates that in certain bottleneck conditions, ACC may even cause extra congestion. These disappointing results can, however, be ameliorated by shortening the “headway” in ACC-equipped vehicles, according to Martin Treiber of the Dresden University of Technology, also in Germany.

Headway is the gap, measured in seconds, that a driver puts between himself and the car ahead. Since ACC reacts more quickly than a human, people who have it fitted can afford to allow less headway.

In his simulation, Dr Davis instructed both his ACC-equipped and his manually driven cars to leave about 1.1 seconds of headway (equivalent to 28 metres at about 100km an hour). Dr Kerner allowed for as much as 1.8 seconds, the distance at which drivers in Germany are taught to follow. But Dr Treiber says 0.9 seconds is safe and realistic. Using this headway in their simulations, he and his colleague Dirk Helbing saw big improvements in traffic flow even in the most dire road conditions. The question remains, of course, of whether real drivers will trust the technology sufficiently to allow it to follow the car in front so closely.

ACC has been an option in a number of luxury vehicles for several years. Now it is becoming available in mid-range cars. But its presence on the roads is still limited, and many people who have it do not use it.

If drivers could be convinced to fit ACC and use it, it would not only improve their own driving experience, but also that of their fellow motorists.

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Information technology

The skinny on IT

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From The Economist print edition

The human body as a computer bus

IT SOUNDS like an April Fool's Day joke, but it isn't. Microsoft, that imperialist of the information-technology world, has actually succeeded in patenting the human body as a computer network. US Patent 6,754,472, issued to the company on June 22nd, is for a “method and apparatus for transmitting power and data using the human body”.

At the moment, übergeeks who want to create a so-called personal area network (PAN) have to link their personal electronic devices—mobile phones, pagers, personal data assistants (PDAs) and so on—using infra-red or radio signals. What Microsoft is proposing is to use the skin's own conductive properties to transmit the data needed to create such a network. And the firm does not stop at people. A “wide variety of living animals”, it says, could be used to create computer buses, as they are known technically, in this manner.

Many people today carry a range of portable electronic devices, each with its own keypad, speaker, display, processing unit and power supply. The idea behind the patent is to get rid of some of these items. If such gizmos were networked, it would be possible to have, say, just one keypad for a mobile phone, an MP3 music player and a PDA. The keypad might even be a person's forearm. As the patent puts it, “The physical resistance offered by the human body can be used in implementing a keypad or other input device as well as estimating distances between devices and device locations. In accordance with the present invention, by varying the distance on the skin between the contacts corresponding to different keys, different signal values can be generated representing different inputs.” In other words you can, in theory, type on your skin.

Microsoft suggests using the body to generate power for the network, too. A “kinetic power converter” in the wearer's shoe or wristwatch would produce electricity in the same way that an old-fashioned self-winding watch extracted energy from its owner's normal movements.

The patent points out that networked portable devices which employ infra-red or radio-frequency communication have limitations. Radio devices use a lot of power, and are prone to interference from others operating on similar frequencies. There are also fears that people might be able to hack into them or, at the least, listen in. Infra-red communication suffers the same problems, but has the additional limitation of requiring a direct line of sight between objects—as anyone who has tried to operate a television remote control with someone else standing between him and the television will know. Microsoft claims that its approach of “near field intrabody communication” does not suffer from these problems, and provides a secure way to transfer data between devices.

It all sounds very revolutionary, but Microsoft is not (as is often the case with the firm's “innovations”) actually the pioneer in the field. The Massachusetts Institute of Technology's Media Laboratory and IBM jointly developed the idea of using the human body as a personal network nearly a decade ago. The first prototype PAN, which was demonstrated at the Comdex trade show in 1996, showed how two people could transmit business-card details to each other electronically, via a handshake. Little has been done since then to take the technology forward, and most people seem satisfied with the capabilities provided by radio-frequency PANs such as Bluetooth.

Microsoft is keeping its cards close to its chest, and has declined to comment on how, exactly, it intends to develop its patent into something that people will actually want to buy. Some of the features of Microsoft's PAN would put off even the most avid technophile—the most obvious being the problem of how the electronic devices it links up are themselves to be attached to the body. The patent suggests a pair of electrodes, attached to the skin, for each device. The trade-off between eliminating redundant

input/output devices and the inconvenience of having to attach dozens of electrodes to your skin does not obviously favour the latter. Still, you have to admire them for trying.

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Reproductive science

A cool conception

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Frozen ovaries could help women to stay fertile

SOMETIMES a little frigidity can do wonders for your sex life—especially if the aim is reproduction. This is particularly true for young women with cancer, since the radiation and chemotherapy required to kill the disease also damage their ovaries and can plunge them into premature menopause. One way to avoid such untimely sterility is to remove an ovary before chemotherapy begins, freeze it, and then implant the tissue back into the patient after she has recovered. But there has been an obstacle. Unlike rugged sperm and hardy embryos, human eggs and the ovaries that contain them have proved extremely difficult to freeze and resurrect.

The miracle of Catholic motherhood

Until now, that is. At this week's meeting of the European Society for Human Reproduction and Embryology, in Berlin, research groups from America, Belgium, Denmark and South Korea announced significant progress in ovarian grafting. Among them were Claus Yding-Andersen and his colleagues at University Hospital of Copenhagen, who removed an ovary from a woman who had Hodgkin's disease, and then grafted slices of it back into her other ovary two years later.

Although the old ovary had shut down during chemotherapy, the new additions sprang to life, producing sex hormones which allowed her eggs to develop and her menstrual periods to resume. The team then harvested some of these eggs and managed to produce a normal embryo through *in vitro* fertilisation. This was tucked back into her womb. Unfortunately, the woman failed to become pregnant. However, Jacques Donnez and his colleagues at the Catholic University of Louvain, in Belgium, have gone one better, with news that they have overcome this hurdle, and that one of their cancer patients who received an ovarian graft has conceived naturally and is expecting a child at the end of September.

If this approach produces a healthy baby, it will create both an opportunity and a dilemma. Storing ovarian tissue does not raise the same religious hackles as freezing embryos. But it could create the possibility of young women banking their ovaries and putting off pregnancy until later in life. Less controversially, as Dr Yding-Andersen points out, such ovarian grafts might also help deal with some of the nastier changes of life, such as osteoporosis, now that conventional hormone-replacement therapy has fallen out of favour. That should get a warm reception.

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About sponsorship

Johannes Vermeer

A lot of exceptional interest

Jul 1st 2004
From The Economist print edition

AFP

The sale of a work by the Dutch master is as rare as Venus passing the sun

ON THE evening of July 7th, amid great excitement, Lot 8 at Sotheby's London sale of old master paintings will come under the hammer. Until recently, the painting's true identity was hidden beneath layers of dirt, but “A Young Woman Seated at the Virginals” has now been fully reinstated as the 36th known painting by Johannes Vermeer. This is the first work by the artist to be sold in over 80 years.

The estimate, of £3m ($5.5m), is widely expected to prove far too low. This is one of only two Vermeers still in private hands (the other belongs to Queen Elizabeth), and is likely to be the last to come on the market for a lifetime. Admiration for the 17th-century Dutch master's work has spread since the publication of a hugely popular novel based on one of his best-known works, “Girl with a Pearl Earring”. The novel's author, Tracy Chevalier, will attend the auction. She says she wants to witness a moment in history.

The painting of the demure young woman at the virginals has a somewhat tarnished past. It is one of two Vermeers bought by a diamond magnate, Alfred Beit, in the 1890s. But an infamous scandal damaged its reputation. In the 1930s, a Dutch artist named Han van Meegeren, feeling unrecognised by the art establishment, vowed to have his revenge by forging “lost” Vermeers to fool the experts.

While Sotheby's expert on old masters, Gregory Rubinstein, calls these forgeries laughable, van Meegeren managed to convince buyers at the time, including Hermann Göring, Hitler's deputy, who bought one for his boss. When van Meegeren was put on trial after the war for selling art to the Nazis, he insisted that the work had been fake. To prove it, he painted one during his trial, and was then imprisoned for forgery rather than treason.

The bolt and the blue

The scandal caused the art world to reconsider questionable Vermeers, including the Beit family's young woman. In a book published in 1948, the most renowned Vermeer scholar of the day, A.B. de Vries, called it a fake. He later changed his mind, and wrote a letter saying he would reinstate the painting as a Vermeer in the next edition of his book—but there were no further editions.

The painting languished in a kind of art-world purgatory until the Beit family consigned it to a London gallery in 1960. There it was sold to a Belgian collector, Baron Frédéric Rolin, who traded it for four of his own paintings because he thought he glimpsed the spirit of Vermeer beneath its faded beauty. In 1993, Rolin asked Sotheby's Mr Rubinstein to investigate the work. After ten years, an international committee of art historians and restorers unanimously reattributed it to Vermeer.

While the historians were uneasy about certain parts that seemed not to be by the careful hand of Vermeer, the restorers cleaned the picture to reveal that these were later retouchings. Furthermore, they discovered that the painting was made from the same bolt of canvas used for Vermeer's “Lacemaker” painting, which is in the Louvre in Paris. But the great breakthrough was in the analysis of the pigment. Among 17th-century artists, the use of the precious blue ultramarine pigment was rare and reserved for the most conspicuous parts of the canvas. Vermeer is the only painter known to have ground lapis lazuli into tiny particles of ultramarine and painted it on the background. He also used it in unexpected places, such as the chair in this painting, to lend seemingly insignificant details a jewel-like quality.

After these revelations, even sceptical committee members agreed that the work was by the Dutch master. Frits Duparc, director of the Mauritshuis in The Hague, home of three Vermeers including “Girl with a Pearl Earring” and “View of Delft”, was the last to change his mind. “Today we can see Vermeer's subtlety in the painting,” he says. “But I still don't think it's one of his best; the yellow shawl, for example, may be by another hand.”

The tiny painting, no bigger than the cover of *The Economist*, dates from 1672, a year of disaster for Delft, Vermeer's home town. Holland was invaded by the French and the local economy went into decline. For Mr Duparc, Vermeer's painting after that date is of lesser quality, reflecting the fact that he was a father of 11 children who suddenly had to paint for a living. His painstaking attention to detail (hence his small output) suffered, and three years later he died impoverished at the age of 43. Saying a Vermeer is not the best, however, is like complaining that a diamond is not flawless. Likely bidders for the work could include museums without a Vermeer (the Getty, for example), the city of Delft, which is desperate to show a Vermeer in his home town, or a billionaire collector.

Whoever purchases the painting will be aware that Vermeers make appealing targets for thieves. As Matthew Hart writes in “The Irish Game”,* the Beits' other Vermeer—“Lady Writing a Letter with her Maidservant”—was stolen twice from its palatial home in rural Ireland before ending up at the National Gallery in Dublin. Although it is impossible to sell such famous works on the open market, in the criminal underworld they are valued at somewhere around 7% of their true worth, which makes them useful collateral for the drugs and arms trade.

While Mr Hart's account is the first to chronicle the complex tale of the Beit art theft, it occasionally reads like a TV docu-drama script. For a real sense of Vermeer's mystique, the best book remains Ms Chevalier's “Girl with a Pearl Earring”. Of Vermeer's women, Ms Chevalier says it is their restraint that is so appealing and that no other artist has created. “This painting,” she says of Lot 8, “is the last of its kind.”

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* The Irish Game: A True Story of Crime and Art. By Matthew Hart. Walker & Company; 224 pages; $24. Chatto & Windus; £15

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About sponsorship

Tony Blair

Not too great. Just too greatly liked

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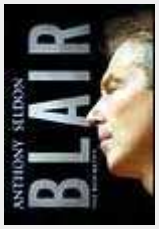
NOT many weeks ago, a group of people who like to think they are in the know had convinced themselves that, by the end of the year, Tony Blair would no longer be Britain's prime minister. If they had been right, the timing of Anthony Seldon's new biography would have been nothing short of miraculous. Now, however, most sensible observers believe that nothing, other than an unlikely rejection by voters, will prevent Mr Blair from soldiering on for at least another three years, until he reaches his tenth anniversary as prime minister.

Blair
By Anthony Seldon



Free Press; 755 pages; £20

Buy it at Amazon.co.uk

The result is that some of the verdicts which Mr Seldon reaches about his subject should be seen as more provisional than the author suggests. It is still not clear whether Mr Blair's efforts to modernise Britain's creaking public services will be seen as a partial success or as proof that the whole enterprise was doomed from the outset without more radical reforms and a different approach to funding. Similarly, despite the currently fashionable consensus that Iraq has been an unmitigated disaster, it is conceivable that by the time Mr Blair quits the scene the decisions that he took in the run-up to war will appear in a better light than now.

Mr Seldon's conclusions about Mr Blair's place in history occupy only a small part of this weighty book, but they are important because they set what precedes them in an almost elegiac light. His judgment that Mr Blair, while not a bad prime minister, cannot claim a place in a first rank that includes Asquith, Attlee, Churchill and Thatcher, is both hard to disagree with and unlikely to alter. But whereas Mr Seldon appears to see this as an almost tragic denouement, an example of limitless promise, if not betrayed, at least unfulfilled, this is both too harsh and too grand.

At least three of the four “greats” of the last century had mandates to remake Britain as a different place. For all the size of Mr Blair's majorities in 1997 and 2001, he was elected as an ameliorator rather than what the management consultants call a “change agent”. Voters liked him precisely because there was no off-putting ideological glint in his eye or burning desire to break too much with the recent, moderately successful past. And while Iraq must take most of the blame for his loss of popularity, it is also possible that voters find his newly-discovered radicalism unsettlingly at odds with the Blair of the first five years.

That said, based on more than 600 interviews with people close to the action, this is an impressively complete and up-to-date account of the personalities and events that have formed Labour's longest-serving prime minister. Although not authorised in the traditional sense—and thus not constrained—many of those within Mr Blair's inner circle have clearly trusted the author and his numerous researchers sufficiently to talk freely and candidly.

In a novel technique, Mr Seldon punctuates the chronological narrative with chapters devoted to a series of people, about 20 in all, who have played a key part in Mr Blair's life—from his parents to Peter Mandelson, Gordon Brown, George W. Bush and God. Some readers will find that the device irritatingly slows the story down. But it not only provides a handle on important characters who would otherwise have only walk-on parts, such as Anji Hunter, a close friend and confidante who ran Mr Blair's office both before and after he became prime minister. It also helps to give a new insight into what is perhaps Mr Blair's greatest political gift: his extraordinary ability to make (almost) everyone who comes into his orbit like him, and to go on liking him even when experience tells them they should know better.

Blair.
By Anthony Seldon.
Free Press; 755 pages; £20

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New fiction

A travesty of honour

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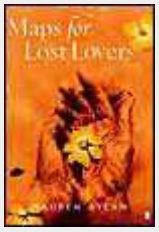
NADEEM ASLAM may be tempting the same fate as befell Salman Rushdie. His first novel in more than a decade is a study of what can happen to Muslims who flout the conventions of their religion. It is so anti-clerical that it would be no surprise were the author to become the subject of a fatwa.

In an unnamed English town, two young Pakistani immigrants, Jugnu and Chanda, set up home without marrying. Within weeks, they are dead. On a snowbound January morning, Chanda's two brothers are arrested and charged with murder. Their community believes they will be exonerated for defending the honour of Islam; the British justice system decides otherwise. “Maps for Lost Lovers” tells the story of the next 12 months.

Maps for Lost Lovers
By Nadeem Aslam



Faber and Faber; 384 pages; £16.99

Buy it at
Amazon.co.uk

The killing, rather than taking up a central position in the story, acts as a mirror of the close-knit Pakistani community, especially for Jugnu's brother and sister-in-law, Shamas and Kaukab. As the seasons pass, and Shamas faces first desolation and then temptation and adultery, his wife struggles to maintain her Islamic piety while trying to come to terms with the double murder and its terrible effect on her marriage, her family and everything the couple was brought up to believe in.

Two things raise this book from a prosaic work of social commentary into an illuminating piece of contemporary fiction: Mr Aslam's arresting prose that quietly and eloquently opens up the heart of Shamas and Kaukab's family, and the author's courage in questioning the more outrageous laws that are enacted in Islam's name. So-called honour killings among Muslims in Europe are on the increase. British police recently reviewed 117 murder cases over the past ten years where such motives may have been involved.

“Maps for Lost Lovers” is a novel of extraordinary quality. Islamists would be foolish to try to make political mischief out of it, while western readers would be foolish to ignore such a carefully crafted work.

Maps for Lost Lovers.
By Nadeem Aslam.
Faber and Faber; 384 pages; £16.99

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About sponsorship

Lobsters

Pots of flesh

Jul 1st 2004
From The Economist print edition

LOBSTER has long been known as a luxury food. But in colonial days in North America the crustacean was so plentiful and cheap that it was used to feed prisoners and indentured servants in place of valuable cod and mackerel. One group of Massachusetts servants became so fed up with their diet of lobster that they took their owners to court and won a judgment that it not be served to them more than three times a week.

Times, of course, have changed. Nowadays lobster is viewed as an expensive, high-status delicacy. Only a few months ago, Norma's restaurant at Le Parker Meridien hotel in New York was offering a lobster and caviar omelette priced at $1,000.

These two lively books look at different aspects of man's relationship with *Homarus americanus*, the American lobster, along the 4,500-mile rocky coast of Maine. The north-eastern American state is the most famous lobster fishery in the world; the noble crustacean earns its 7,000 lobster fishermen $150m-180m a year.

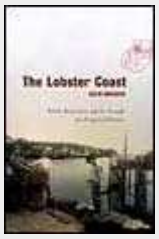
In “The Lobster Coast”, Colin Woodard uses the fishermen of Monhegan Island as the focus for a broad historical sweep, ranging from the settlers who arrived in Maine a decade before the *Mayflower* landed at Plymouth, to onslaughts from Indian tribes, raids by the French and an influx of “rusticators” who put the state on the map as an idyllic holiday destination. The author suggests that Maine's isolated lobster-fishing communities continue to embody Jefferson's Utopian vision of America—“an egalitarian republic of small, self-sufficient producers, where democracy is practised directly by the citizens, and aristocratic privilege is unrecognised or unknown.”

The backbone of Trevor Corson's book is the ecology of lobsters—in particular, the research into why Maine's annual catch continues to rise while the number of lobsters on its sea-bed shows no sign of decreasing. Based on Little Cranberry Island, “The Secret Life of Lobsters” explains how fear of a decline in stocks led first to open hostility between the state's scientists, fishermen and government officials, and then to collaboration.

Today, Maine's lobstermen are conserving stocks through their willing adherence to state laws which dictate how the fishery is managed. There are limits on the number of lobster traps that can be set, and there are also strict rules on the minimum size that can be caught—which helps ensure that lobsters reproduce before capture—and on the maximum, which keeps the biggest lobsters in the breeding pool. Furthermore, egg-bearing females must be returned to the water, and conservation-minded lobstermen “V-notch” females, cutting a triangular indentation in a tail flipper to help keep them off the dinner table and in the breeding pool.

Both books note that although the conservation ethic of Maine currently supports a viable lobster population, the rugged, salt-scoured island communities themselves are now under threat. Suburbanisation is creeping up the coast and the purchasers of second homes are pricing locals out of the property market. While it appears that the future of the lobster is assured—at least for a while—the future of Maine's lobstermen is not.

The Lobster Coast: Rebels, Rusticators, and the Struggle for a Forgotten Frontier
By Colin Woodard



Viking; 372 pages; $24.95

Buy it at
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The Secret Life of Lobsters: How Fishermen and Scientists are Unraveling the Mysteries of our Favorite Crustacean
By Trevor Corson

HarperCollins; 289 pages; $24.95

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About sponsorship

Guantanamo on stage

But is it theatre?

Jul 1st 2004
From The Economist print edition

A controversial new play

Bound. To defend freedom?

THE cast does not take a bow at the end of “Guantanamo”, a new drama that draws on the testimony of numerous detainees at Camp Delta, the American facility for “enemy combatants” at Cuba's Guantanamo Bay. And, after nearly two hours delivering accounts of wrongful incarceration and mistreatment, the actors are probably no more inclined to indulge the time-honoured artifice of the curtain call than the audience is to receive it. Instead, the production ends with the sight of various detainees continuing to go quietly about their business.

Clearly “Guantanamo” is not standard West End fare, and its presence at London's New Ambassadors Theatre, where it opened last weekend for a commercial run scheduled for the moment at 12 weeks, is even more surprising given the usual silliness of the summer season. This year this includes the return of “Saturday Night Fever”—a show hardly due yet for an encore—and a former “brat-pack” movie star, Molly Ringwald, making her British stage debut in “When Harry Met Sally”.

Against such frivolity, it might be tempting to regard “Guantanamo: Honor Bound To Defend Freedom” (the subtitle comes from an actual sign announcing what Camp Delta sees as its duty) as contrastingly worthy, perhaps even self-righteous. In fact, it is too bedded in the detail of individual lives to be either of these things, as if everyone involved was well aware that the political is always more trenchant when rooted in the personal.

To that end, “Guantanamo” often works best as an exercise in story-telling, albeit as culled from the actual words of the people involved. The play's two authors, Gillian Slovo and Victoria Brittain, could more accurately be described as redactors whose job it was to make a coherent whole out of some 26 hours of taped interviews. (They were hired by Nicolas Kent, artistic director of the Tricycle Theatre in north-west London, where the show was first seen at the end of May.)

The performers, in turn, don't “act” the roles with the sort of embellishments common to stage performances: instead, they function as conduits of a very specific sort, giving voice to a series of Kafkaesque tales that prove doubly unsettling for being true. Actor Aaron Neil, for example, plays Wahab al-Rawi, a wealthy Iraqi émigré to Britain who was arrested with his brother, Bisher, in the Gambia on suspicion of planning a bombing campaign: both men were then taken to Guantanamo, where Bisher remains. What could there possibly be to blow up in the Gambia, Wahab is heard to wonder aloud.

Yes: but is this theatre, the audience might wonder in return? And the answer has to be that it very definitely is, albeit of a particular (and particularly British) sort. Only a few months ago, London's National Theatre produced “The Permanent Way”, a largely (though not entirely) verbatim account of the woes besetting Britain's national railways as assembled by a writer, Sir David Hare, who has often tethered journalism to drama.

With “Guantanamo”, though, there is considerably more at stake, in a climate in which the American Supreme Court ruled just this week that the Bush administration had overreached its powers by depriving “enemy combatants” of access to the American courts. Interestingly, the play opens in New York in August, just in time for the Republican National Convention: politicians from all parties should book their tickets now.

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About sponsorship

Worldwide bestsellers

The big book index

Jul 1st 2004
From The Economist print edition

Bill Clinton's unbrief life goes straight to the top

A MOTLEY mix of subjects on the list of June's top-selling titles via Amazon websites: they include a presidential memoir, punctuational correctness, oriental healing and a medical thriller translated into German. Two of the 15 authors are British, one is Chinese and one is German: the rest are American.

1 My Life. By Bill Clinton. *Knopf; 957 pages; $21 and £15*

The former president's long-winded account of his journey from poverty in Arkansas to million-dollar book advances, via Oxford and the White House. Long on lists and short on editorial discipline, it seems fated to lie unread on the coffee tables of liberal America.

Buy from Amazon.com or Amazon.co.uk

2 Eats, Shoots & Leaves: The Zero Tolerance Approach to Punctuation.
By Lynne Truss. *Gotham Books; 240 pages; $10.50. Profile Books; £5.99*

Buy from Amazon.com or Amazon.co.uk

3 Power Healing: Four Keys to Energizing Your Body, Mind and Spirit.
By Zhi Gang Sha.

HarperSanFrancisco; 272 pages; $11.17 and £7.69

Buy from Amazon.com or Amazon.co.uk

4 The Rule of Four.
By Ian Caldwell and Dustin Thomason.
Dial Press; 384 pages; $14.40. Century; £6.99

Buy from Amazon.com or Amazon.co.uk

5 The Da Vinci Code.
By Dan Brown. *Doubleday; 454 pages; $14.97. Corgi Adult; £6.99*

Buy from Amazon.com or Amazon.co.uk

6 Dress Your Family in Corduroy and Denim.
By David Sedaris. *Little, Brown; 272 pages; $14.97. Abacus; £7.69*

Buy from Amazon.com or Amazon.co.uk

7 Father Joe: The Man Who Saved My Soul.
By Tony Hendra. *Random House; 288 pages; $14.97 and £12.22*

Buy from Amazon.com or Amazon.co.uk

8 Big Russ and Me: A Memoir.

By Tim Russert. *Miramax; 352 pages; $16.06 and £11.24*

Buy from Amazon.com or Amazon.co.uk

9 The Song of Susannah (The Dark Tower, Book 6).
By Stephen King. Donald M. Grant; 413 pages; $18. Hodder & Stoughton; £14

Buy from Amazon.com or Amazon.co.uk

10 Good to Great: Why Some Companies Make the Leap and Others Don't.
By Jim Collins. *HarperCollins; 320; $19.25. Random House; £14*

Buy from Amazon.com or Amazon.co.uk

11 Harii Pottaa to Fushichoo no kishidan.
By J.K. Rowling. *Translated by Yuko Matsuoka. Say-zan-sha Publications; 2 volumes; ¥4,000*

Buy from Amazon.jp

12 Die Chirurgin.
By Tess Gerritsen. *Blanvalet; 416 pages; euro8.95*

Buy from Amazon.de

13 The South Beach Diet: The Delicious, Doctor-Designed, Foolproof Plan for Fast and Healthy Weight Loss.
By Arthur Agatston. *Rodale Press; 310 pages; $14.97. Headline; £7.69*

Buy from Amazon.com or Amazon.co.uk

14 Ten Big Ones: A Stephanie Plum Novel.
By Janet Evanovich. *St Martin's Press; 312 pages; $17.65. Headline; £9.09*

Buy from Amazon.com or Amazon.co.uk

15 Moppel-Ich.
By Susanne Fröhlich. *Krueger; 272 pages; €13.90*

Buy from Amazon.de

Source: Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr, Amazon.jp from May 30th-June 29th. Prices quoted from Amazon.com and Amazon.co.uk are correct as of June 29th.

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About sponsorship

Obituary

Thomas Gold

Jul 1st 2004
From The Economist print edition

Cornell University

Thomas Gold, a maverick astronomer, died on June 22nd, aged 84

AS HENRY KISSINGER once observed, the reason academic disputes are so bitter is that the stakes are so low. Whether you regard understanding the origin of the universe as a low-stakes academic question, or as one of the most fundamental and important intellectual problems imaginable, there is no doubting the bitterness of the dispute which embroiled Thomas Gold when, along with Fred Hoyle and Hermann Bondi, he proposed the idea that the universe had existed for ever.

That was in 1948, when the three of them were keen young astronomers at Cambridge. Dr Gold, like Sir Hermann (as he now is), was an émigré Austrian who had been interned by the British at the beginning of the second world war. (The two met in an internment camp.) Hoyle was a gritty, no-nonsense Yorkshireman. All three were therefore outside the charmed circle that dominated British academia at the time. Their opponent, by contrast, was an insider. Martin Ryle was a nephew of philosopher Gilbert Ryle, and later became England's Astronomer Royal. He was the leading protagonist of a theory contemptuously dismissed by Hoyle as the “Big Bang”.

The “Steady State” theory put forward by Messrs Gold, Hoyle and Bondi held that the universe is infinite in both space and time, and that its infinity in time goes in both directions. No end, then, and no beginning. It also proposed that whenever and wherever you looked, you would see essentially the same pattern of stars and galaxies. To square that with the observable fact that the universe is expanding, and thus might be expected to get less and less dense as it grows older, the three researchers modestly proposed repealing the law of conservation of matter. New atoms, they hypothesised, were being created continuously to fill up the gaps left as the old ones moved apart.

Daring. But contempt is no argument in science, and blue blood is not a barrier to the truth. In the end it turned out that Ryle was right, and the trio were wrong.

When evidence for the Big Bang began to accumulate, Sir Hermann conceded the point. Hoyle, cussed to the last, never did. Nor, really, did Dr Gold. For both he and Hoyle relished their roles as gadflies. And Dr Gold continued to pour out ideas over the years, some of which turned out to be correct and some not.

He got his own back on Ryle, for instance, by claiming in 1951 that some of the signals being detected by the radio telescopes that astronomers were then constructing came from outside the Milky Way galaxy in which the Earth resides. Ryle rejected this idea, and Ryle was wrong. It was an ironic victory, though, for the killer evidence supporting the Big Bang was also an extra-galactic radio signal—one left over from the

primordial fireball itself. That was discovered in 1965.

Dr Gold was also on the money with his explanation of pulsars. These regularly ticking astronomical radio sources caused a sensation when they were discovered in 1967. Indeed, the first was known unofficially as LGM1, because its discoverers half wondered whether they had come across the first trace of little green men in outer space.

Dr Gold's explanation was only slightly more prosaic. It was that pulsars are rotating neutron stars, the super-dense last stage of collapse of a star not quite heavy enough to form a black hole. That hypothesis is now universally accepted.

But the big idea of Dr Gold's whose proof or disproof is pending is the “deep, hot biosphere”. This is the theory that life is not merely a surface scum which clings to the outside of planet Earth, but that living things, in the form of so-called extremophile bacteria which can tolerate infernal heat, penetrate several kilometres into the planet's interior.

He who laughs last...

The deep, hot biosphere theory is bound up with another Gold idea, that natural gas and petroleum do not derive from fossil animals and plants but rise up from deep inside the Earth. These fuels, Dr Gold believed, are left over from the planet's formation 4.5 billion years ago. The reason, he reckoned, that they contain molecules of undoubted biological origin (which is why they are usually thought to be fossil) is because the deep, hot extremophiles have been feeding on them as they rise.

This theory, while on the outer fringes of plausibility, is not completely bonkers. Heat-loving extremophile bacteria certainly exist. Primordial astronomical objects such as comets (the sort of stuff from which the Earth is presumed to have formed), certainly contain hydrocarbons of the type that compose oil and gas.

The scientific establishment has been as sniffy about the deep, hot biosphere and the inorganic origin of hydrocarbon fuels as it was about the Steady State theory. But the scientific establishment is not always right. It may be that Dr Gold will have the last laugh and, if he does, not even Henry Kissinger should be cynical about the consequences. For it would mean that hydrocarbons are vastly more abundant on Earth than anyone has hitherto believed, and that if you drill deep enough, you should be able to find them almost anywhere. Perhaps the stakes in the groves of academe are not always that low, after all.

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Overview

Jul 1st 2004
From The Economist print edition

The **Federal Reserve** raised interest rates at its meeting on June 30th by one-quarter of a percentage point to 1.25%, its first rate hike since May 2000. The Fed's Open Market Committee conceded in its statement that recent inflation figures have been “somewhat elevated”, yet it also said that at least a portion of the rise in inflation was thanks to “transitory factors.” The committee maintained its commitment to “measured” rate increases, but also continued to leave open the possibility that it might need to raise rates more quickly.

America's first-quarter GDP growth was revised down from 4.4% to 3.9% at an annual rate. More worryingly, core inflation in the first quarter, excluding food and energy prices, was revised up from 1.7% to 2.0% at an annual rate.

Consumer confidence in America seems to be holding up strongly. The University of Michigan's index rose to 95.6 in June from 90.2 in May. The Conference Board's consumer confidence index jumped to 101.9 in June, from 93.1 in May, as petrol prices fell and the number of jobs rose.

In what might be the last hurrah for America's **housing market**, as higher interest rates dampen enthusiasm for mortgages, sales of existing homes set a new record of 6.8m units.

Consumer prices in the **euro area** rose by 2.4% in the year to June, down from 2.5% in the year to May. The European Commission's index of economic sentiment in the euro area crept down to 99.8 from 100.1, thanks to fading confidence in the services industry, retailing and industrial firms.

The **Japanese economy** continues to rebound. Industrial production rose by 4.2% in the year to May. Unemployment fell to 4.6%, in May, down from 4.7% in April, and much lower than the 5.4% rate a year ago.

Retail sales volumes rose by 5.4% in the year to May in **Sweden**.

Britain's current-account deficit in the first quarter was unchanged from the previous quarter at £5.3 billion ($9.8 billion), and much lower than expectations thanks to strong growth in exports of services and investment income. GDP growth in the year to the first quarter was revised up to 3.4%, from an earlier estimate of 3.0%, thanks to a higher estimate of investment spending.

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Output, demand and jobs

Jul 1st 2004
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate	
	latest	qtr*	2004	2005	latest		latest		latest	year ago
Australia	+ 3.2 Q1	+ 0.9	+ 3.8	+ 3.1	– 0.9 Q4		+ 7.7 Q1		5.5 May	6.1
Austria	+ 0.5 Q1	+ 0.8	+ 1.6	+ 1.9	+ 5.6 Apr		+ 2.6 Mar		4.4 May	4.4
Belgium	+ 2.0 Q1	+ 3.0	+ 1.9	+ 2.0	– 1.0 Apr		+ 0.9 Apr		12.3 May†	11.4
Britain	+ 3.4 Q1	+ 2.9	+ 3.1	+ 2.6	+ 0.5 Apr		+ 7.4 May		4.8 Apr††	5.1
Canada	+ 1.6 Q1	+ 2.4	+ 2.8	+ 3.3	+ 2.8 Apr		+ 4.9 Mar		7.2 May	7.9
Denmark	+ 1.3 Q1	+ 2.3	+ 2.0	+ 2.2	+ 3.3 Apr		+ 1.5 May		6.5 Apr	5.9
France	+ 1.7 Q1	+ 3.1	+ 2.1	+ 2.2	+ 1.1 Apr		+ 2.7 Apr		9.8 May	9.7
Germany	+ 1.5 Q1	+ 1.8	+ 1.4	+ 1.7	+ 2.2 Apr		– 2.3 May		10.5 May§	10.7
Italy	+ 0.8 Q1	+ 1.8	+ 1.1	+ 1.7	+ 0.2 Apr		– 2.7 Mar		8.5 Jan	8.9
Japan	+ 5.6 Q1	+ 6.1	+ 4.1	+ 2.1	+ 4.2 May		– 0.5 Apr		4.6 May	5.4
Netherlands	+ 0.9 Q1	+ 2.8	+ 1.1	+ 1.7	+ 1.1 Apr		– 2.3 Mar‡		6.5 May**	5.1
Spain	+ 2.8 Q1	+ 2.6	+ 2.8	+ 2.8	+ 0.9 Apr		+ 4.3 Apr		11.2 Apr	11.3
Sweden	+ 2.6 Q1	+ 2.6	+ 2.5	+ 2.5	+ 4.3 Apr		+ 5.4 May		5.3 May†	4.2
Switzerland	+ 1.5 Q1	+ 1.6	+ 1.7	+ 1.9	+ 4.5 Q1		+ 1.6 Apr		3.8 May†	3.6
United States	+ 4.8 Q1	+ 3.9	+ 4.7	+ 3.6	+ 6.3 May		+ 8.5 Apr		5.6 May	6.1
Euro area	+ 1.3 Q1	+ 2.3	+ 1.7	+ 2.0	+ 1.7 Apr		+ 1.0 Apr		9.0 Apr	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*									
Finland	+ 2.7 Q1	+ 3.0	na	na	+ 7.2 May		+ 4.8 Mar		11.6 May†	11.4
Greece	+ 4.0 Q1	+ 3.0	na	na	+ 1.8 Apr		+ 5.4 Mar		na	na
Iceland	+ 4.9 Q1	na	na	na	na		na		3.5 Apr†	3.9
Ireland	+ 2.7 Q4	na	na	na	+ 2.7 Apr		+ 5.0 Mar		4.5 May	4.4
Luxembourg	+ 2.12003	na	na	na	– 1.2 Dec		+ 0.1 Jan		4.3 Apr	3.6
New Zealand	+ 4.4 Q1	+ 8.1	na	na	+ 3.2 Q4		+ 8.0 Q1		4.3 Q1	4.9
Norway	+ 2.9 Q1	+ 3.9	na	na	+ 0.7 Apr		+ 1.2 May		4.5 Q1	4.4
Portugal	+ 0.1 Q1	+ 2.4	na	na	– 3.2 Apr		+ 3.6 Apr		6.4 Q1†	6.4

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Feb-Apr; claimant count rate 2.8% in May. §EU harmonised rate 9.8% in May. **Mar-May.

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Prices and wages

Jul 1st 2004
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.0	Q1	+ 3.4	+ 2.3	+ 2.6	– 1.1	Q1	+ 3.0	+ 5.1	Q1	+ 4.4
Austria	+ 2.1	May	+ 1.1	+ 1.5	+ 1.5	+ 6.1	May	+ 0.6	+ 2.2	Apr	+ 2.2
Belgium	+ 2.3	Jun	+ 1.6	+ 1.5	+ 1.5	+ 3.9	May	– 0.4	+ 2.3	Apr	+ 1.7
Britain	+ 1.5	May*	+ 1.2	+ 1.5	+ 1.8	+ 2.4	May	+ 1.1	+ 4.3	Apr†	+ 3.2
Canada	+ 2.5	May	+ 2.9	+ 1.6	+ 2.0	+ 1.5	Apr	– 0.5	+ 3.0	Mar	+ 1.6
Denmark	+ 1.3	May	+ 2.2	+ 1.4	+ 2.0	+ 2.8	May	– 0.6	+ 3.3	Q1	+ 3.9
France	+ 2.6	May	+ 1.8	+ 2.0	+ 1.6	+ 2.3	May	+ 0.7	+ 2.8	Q1	+ 2.9
Germany	+ 1.8	Jun	+ 1.0	+ 1.4	+ 1.2	+ 3.6	May	– 0.4	+ 1.1	Apr	+ 3.3
Italy	+ 2.4	Jun	+ 2.7	+ 2.2	+ 2.1	+ 2.9	May	+ 1.6	+ 3.3	May	+ 1.7
Japan	– 0.5	May	– 0.2	– 0.1	+ 0.1	+ 1.1	May	– 1.1	+ 0.7	Apr	+ 1.8
Netherlands	+ 1.5	May	+ 2.0	+ 1.4	+ 1.3	+ 2.1	Apr	+ 1.4	+ 1.6	May	+ 3.0
Spain	+ 3.4	May	+ 2.7	+ 2.6	+ 2.6	+ 3.8	May	+ 0.7	+ 3.2	Q1	+ 4.9
Sweden	+ 0.7	May	+ 1.9	+ 0.8	+ 1.6	+ 1.2	May	– 1.4	+ 1.5	Mar	+ 1.5
Switzerland	+ 1.1	Jun	+ 0.6	+ 0.4	+ 0.9	+ 1.4	May	– 0.5	+ 1.4	2003	+ 1.8
United States	+ 3.1	May	+ 2.1	+ 2.3	+ 2.0	+ 4.9	May	+ 2.4	+ 2.2	May	+ 3.0
Euro area	+ 2.4	Jun	+ 1.9	+ 1.8	+ 1.7	+ 1.4	Apr	+ 1.7	+ 2.3	Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	– 0.1	May	+ 0.7	na	na	+ 1.6	May	– 0.7	+ 4.1	Q1	+ 4.1
Greece	+ 2.9	May	+ 3.8	na	na	+ 2.8	Apr	+ 1.0	na		na
Iceland	+ 3.9	Jun	+ 1.8	na	na	+ 5.0	May	+ 3.0	+ 4.6	May	+ 5.6
Ireland	+ 1.7	May	+ 3.7	na	na	– 0.1	May	–10.0	+ 6.1	Q4	+ 6.4
Luxembourg	+ 2.3	May	+ 1.9	na	na	+ 2.3	Mar	+ 2.6	– 0.4	Dec	+ 0.7
New Zealand	+ 1.5	Q1	+ 2.5	na	na	– 0.6	Q1	– 1.3	+ 2.2	Q1	+ 2.3
Norway	+ 1.0	May	+ 2.1	na	na	+18.8	May	– 4.5	+ 4.6	Q1	+ 5.3
Portugal	+ 2.4	May	+ 3.7	na	na	+ 1.8	May	+ 1.1	– 1.5	Apr	+ 0.7

*New series. RPI inflation rate in May: 2.8%. † Feb-Apr

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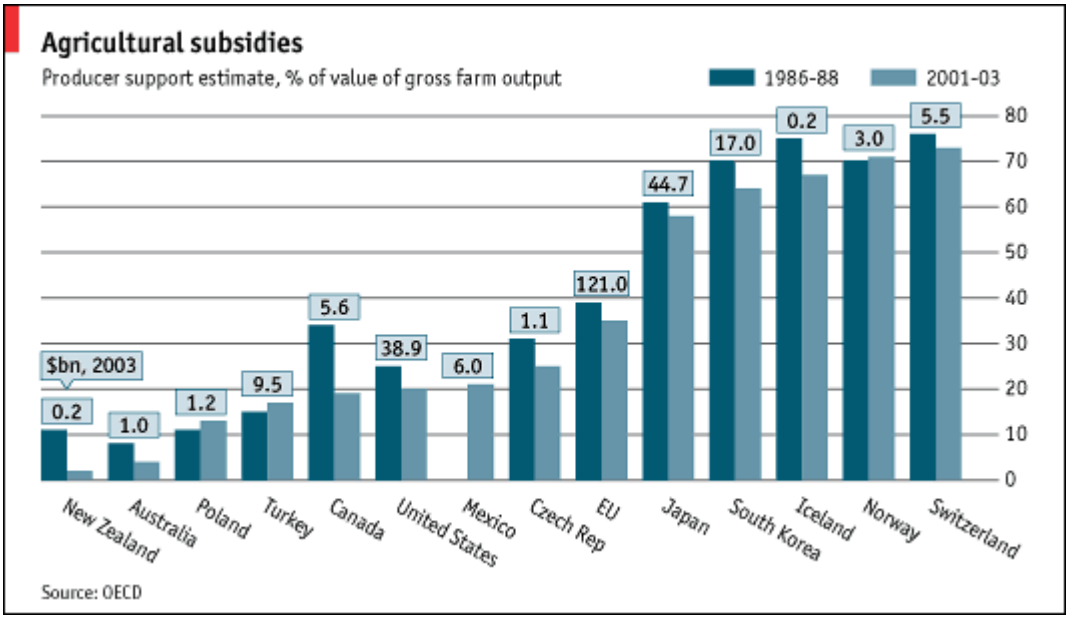
Agricultural subsidies

Jul 1st 2004
From The Economist print edition



Farm subsidies, measured as a percentage of the value of farm output, have been declining in most places since the late 1980s. But they remain enormous. The European Union spent $121 billion supporting agriculture in 2003, while America lavished $39 billion on its farmers. Japan, South Korea, Iceland, Norway and Switzerland all provide farm subsidies that are worth well over half of national farm output.

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Money and interest rates

Jul 1st 2004
From The Economist print edition

Money and interest rates

	Money supply* % change on year ago			Interest rates % p.a. (Jun 30th 2004) 3-mth money market		2-year gov't bonds	10-year gov't bonds		corporate bonds
	narrow	broad		latest	year ago		latest	year ago	
Australia	+ 4.3	+10.3	May	5.48	4.72	5.24	5.93	5.07	6.68
Britain	+ 5.2	+ 7.9	May	4.81	3.63	4.86	5.09	4.25	5.91
Canada	+12.4	+ 8.6	May	2.04	3.09	3.32	5.19	4.54	6.37
Denmark	+ 7.9	+ 9.0	May	2.25	2.25	2.62	4.42	4.01	5.61
Japan	+ 4.2	+ 2.0	May	0.02	0.01	0.18	1.76	0.88	1.91
Sweden	+ 0.7	+ 3.7	May	1.97	2.71	3.01	4.60	4.26	3.06
Switzerland	+ 9.4	+ 4.3	May	0.50	0.28	1.43	2.85	2.41	2.74
United States	+ 5.1	+ 5.5	May	1.43	1.03	2.79	4.61	3.53	6.09
Euro area†	+ 9.3	+ 4.7	May	2.07	2.15	2.67	4.26	3.82	4.11

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 5.30%, Japan No. 260 1.78%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.50%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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Stockmarkets

Jul 1st 2004
From The Economist print edition

Market indices

	Jun 30th	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,530.3	3,547.4	3,547.4	- 0.4	- 0.5	+ 6.8	- 1.2
Austria (ATX)	1,989.4	1,985.9	1,991.7	+ 1.8	nil	+28.8	+24.2
Belgium (Bel 20)	2,470.7	2,517.3	2,517.3	+ 0.8	-32.9	+10.1	+ 6.2
Britain (FTSE 100)	4,464.1	4,575.7	4,575.7	- 0.5	-35.6	- 0.3	+ 1.0
Canada (Toronto Composite)	8,545.6	8,898.8	8,898.8	- 0.3	-25.0	+ 3.9	+ 0.2
Denmark (KBX)	238.6	241.3	241.3	+ 1.0	-20.9	+11.7	+ 8.0
France (SBF 250)	2,550.4	2,594.4	2,594.4	+ 0.7	-41.9	+ 5.8	+ 2.0
(CAC 40)	3,733.0	3,811.4	3,811.4	+ 0.3	-46.1	+ 4.9	+ 1.2
Germany (DAX)	4,052.7	4,151.8	4,151.8	+ 2.7	-49.7	+ 2.2	- 1.4
Italy (BCI)	1,327.1	1,340.3	1,340.3	+ 0.7	-39.2	+ 5.6	+ 1.9
Japan (Nikkei 225)	11,858.9	12,163.9	12,163.9	+ 2.4	-69.5	+11.1	+ 9.1
(Topix)	1,189.6	1,217.9	1,217.9	+ 2.9	-58.8	+14.0	+12.0
Netherlands (AEX)	345.1	364.8	364.8	+ 1.4	-50.8	+ 2.2	- 1.4
Spain (Madrid SE)	850.5	881.7	881.7	- 0.2	-25.8	+ 5.3	+ 1.5
Sweden (Affarsvarlden Gen)	206.0	218.1	218.1	+ 1.1	-48.6	+ 9.3	+ 4.4
Switzerland (Swiss Market)	5,619.1	5,934.4	5,934.4	- 0.6	-33.2	+ 2.4	+ 1.1
United States (DJIA)	10,435.5	10,737.7	10,737.7	- 0.4	-11.0	- 0.2	- 0.2
(S&P 500)	1,140.8	1,157.8	1,157.8	- 0.3	-25.3	+ 2.6	+ 2.6
(NASDAQ Comp)	2,047.8	2,153.8	2,153.8	+ 1.3	-59.4	+ 2.2	+ 2.2
Europe (FTSE Eurotop 300)*	998.3	1,026.2	1,026.2	- 0.2	-41.4	+ 4.2	+ 0.5
Euro area (FTSE Ebloc 100)*	852.8	888.3	888.3	+ 0.8	-45.0	+ 2.5	- 1.1
World (MSCI)†	1,062.5	1,085.8	1,085.8	+ 0.3	-26.7	+ 2.5	+ 2.5
World bond market (Citigroup)‡	594.5	619.5	619.5	+ 0.6	- 4.0	- 1.5	- 1.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jul 1st 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		Current account The Economist poll % of GDP, forecast 2004	Current account The Economist poll % of GDP, forecast 2005	Exchange rate trade-weighted† 1990=100 Jun 30th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Jun 30th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2004‡
Australia	− 16.6	May	− 33.0	Q1	− 5.2	− 4.5	82.5	84.9	1.43	1.47	2.60	1.75	1.32	0.5
Austria	− 0.8	Mar	− 1.4	Apr	+ 0.4	+ 0.5	102.8§	102.3	0.82	0.87	1.49	–	0.75	-1.3
Belgium	+ 21.8	Apr	+ 12.2	Mar	+ 3.9	+ 3.9	102.7§	102.2	0.82	0.87	1.49	–	0.75	-0.2
Britain	− 89.4	Apr	− 39.2	Q1	− 2.6	− 2.6	104.8	100.9	0.55	0.60	–	0.67	0.51	-2.9
Canada	+ 47.8	Apr	+ 20.9	Q1	+ 1.8	+ 1.3	86.1	87.2	1.34	1.34	2.43	1.63	1.23	1.2
Denmark	+ 9.2	Apr	+ 6.4	Apr	+ 2.6	+ 2.5	106.4	106.5	6.11	6.45	11.1	7.43	5.60	0.9
France	+ 4.6	Apr	+ 10.5	Apr	+ 0.9	+ 0.8	106.1§	105.4	0.82	0.87	1.49	–	0.75	-3.8
Germany	+174.2	Apr	+ 74.3	Apr	+ 2.6	+ 2.6	103.8§	102.9	0.82	0.87	1.49	–	0.75	-3.7
Italy	+ 2.6	Apr	− 16.2	Apr	− 1.0	− 0.9	75.7§	75.1	0.82	0.87	1.49	–	0.75	-3.1
Japan	+121.4	Apr	+157.2	Apr	+ 3.3	+ 3.3	135.2	127.3	109	119	198	133	–	-7.1
Netherlands	+ 33.1	Apr	+ 18.7	Q1	+ 2.6	+ 2.7	102.1§	101.6	0.82	0.87	1.49	–	0.75	-3.1
Spain	− 56.5	Mar	− 27.0	Mar	− 2.9	− 3.0	76.9§	76.6	0.82	0.87	1.49	–	0.75	0.3
Sweden	+ 21.7	May	+ 21.2	Q1	+ 5.9	+ 5.6	80.9	80.5	7.53	7.98	13.7	9.17	6.90	0.2
Switzerland	+ 7.9	May	+ 32.8	Q4	+10.6	+10.3	113.7	111.4	1.25	1.35	2.27	1.52	1.15	-1.6
United States	−568.9	Apr	−537.3	Q1	− 5.1	− 5.1	97.1	102.4	–	-	1.81	1.22	0.92	-4.7
Euro area	+103.0	Apr	+ 52.8	Apr	+ 0.4	+ 0.4	90.2	90.2	0.82	0.87	1.49	–	0.75	-2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 14.8	Apr	+ 11.2	Apr	na	na	81.7§	81.1	0.83	0.87	1.51	–	0.76	1.6
Greece	− 27.2	Apr	− 10.4	Apr	na	na	59.4§	59.1	0.83	0.87	1.51	–	0.76	-3.2
Iceland	− 0.3	May	− 0.7	Q1	na	na	96.5**	97.2	72.7	76.5	132	88.5	66.6	0.2
Ireland	+ 42.8	Mar	− 3.0	Q4	na	na	93.6§	93.4	0.83	0.87	1.51	–	0.76	-0.5
Luxembourg	− 3.7	Mar	+ 3.2	Q1	na	na	102.7§	102.2	0.83	0.87	1.51	–	0.76	-1.8
New Zealand	− 2.1	May	− 3.4	Q1	na	na	101.8	100.0	1.60	1.68	2.90	1.95	1.47	2.9
Norway	+ 28.6	May	+ 28.9	Apr	na	na	95.3	97.5	6.93	7.16	12.6	8.43	6.35	10.4
Portugal	− 14.4	Mar	− 8.3	Apr	na	na	93.6**	92.7	0.83	0.87	1.51	–	0.76	-3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD forecast. **IMF, March average.

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About sponsorship

The Economist commodity price index

Jul 1st 2004
From The Economist print edition

1995=100

	Jun 22nd	Jun 29th*	% change on one month	% change on one year
Dollar index				
All items	94.2	94.8	– 2.9	+24.7
Food	91.8	92.1	– 3.4	+20.7
Industrials				
All	97.5	98.4	– 2.2	+30.1
Nfa†	92.6	92.6	– 4.4	+15.8
Metals	101.6	103.3	– 0.5	+43.6
Sterling index				
All items	81.7	82.1	– 2.0	+13.8
Euro index				
All items	102.5	103.1	– 1.9	+19.6
Yen index				
All items	109.3	109.9	– 3.7	+14.0
Gold				
$ per oz	396.00	394.00	– 0.3	+12.0
West Texas Intermediate				
$ per barrel	38.03	35.61	–15.9	+18.1

* Provisional. † Non-food agriculturals.

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About sponsorship

Foreign direct investment

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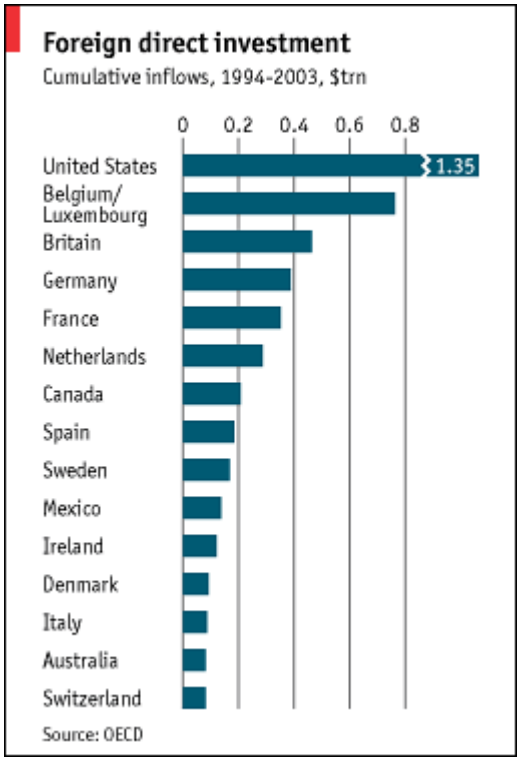
From The Economist print edition



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Overview

Jul 1st 2004
From The Economist print edition

India's GDP growth slowed to 8.2% in the year to the first quarter, from 10.4% in the year to the fourth quarter.

Turkey's economy grew by 10.1% in the year to the first quarter, outpacing expectations.

Industrial production grew by 17.1% in the year to April in **Indonesia,** and by 21.0% in the year to May in **Singapore**.

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Alcohol consumption

Jul 1st 2004
From The Economist print edition

Luxembourg leads the world in alcohol consumption. In 2002, its residents consumed an average of 12 litres of pure alcohol per person, in the form of beer, wine and spirits. Mexicans, by contrast, enjoyed only around a quarter as much. Some countries have been curbing their drinking. In France, for example, alcohol consumption fell by 30% between 1980 and 2002. Over the same period, however, beer-loving Czechs increased their alcohol intake by 12%.

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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.8	Q1	+17.5	May	+ 4.4	May	+15.6	May	+45.9	2003	444.4	Mar
Hong Kong	+ 6.8	Q1	+ 1.8	Q1	– 0.9	May	–12.3	May	+14.3	Q1	120.1	May
India	+ 8.2	Q1	+ 9.4	Apr	+ 2.2	Apr	–16.4	May	+ 3.2	Q4	114.3	May
Indonesia	+ 4.5	Q1	+17.1	Apr	+ 6.8	Jun	+27.8	May	+ 7.4	Q4	35.9	Apr
Malaysia	+ 7.6	Q1	+14.0	Apr	+ 1.2	May	+20.4	Apr	+13.0	Q1	53.6	May
Philippines	+ 6.4	Q1	– 5.2	Apr	+ 4.5	May	– 1.7	Apr	+ 3.9	Mar	13.3	May
Singapore	+ 7.5	Q1	+21.0	May	+ 2.0	May	+15.1	May	+27.6	Q1	101.1	May
South Korea	+ 5.3	Q1	+13.5	May	+ 3.3	May	+26.5	May	+24.1	May	166.5	May
Taiwan	+ 6.3	Q1	+16.6	May	+ 0.9	May	+14.6	May	+27.4	Q1	229.0	May
Thailand	+ 6.5	Q1	+ 6.8	May	+ 2.4	May	+ 2.2	May	+ 7.4	May	41.6	Apr
Argentina	+10.7	Q1	+ 6.8	May	+ 4.3	May	+14.4	Apr	+ 6.1	Q1	16.7	May
Brazil	+ 2.7	Q1	+ 6.7	Apr	+ 5.2	May	+28.0	May	+ 6.5	May	50.5	Apr
Chile	+ 4.8	Q1	+ 4.5	May	+ 0.6	May	+ 5.8	May	– 0.1	Q1	16.0	May
Colombia	+ 3.8	Q1	+ 7.1	Mar	+ 5.4	May	+ 0.1	Mar	– 1.4	Q4	11.3	Apr
Mexico	+ 3.7	Q1	+ 4.0	Apr	+ 4.3	May	– 5.4	May	– 9.1	Q1	60.3	Apr
Peru	+ 3.3	Apr	+ 5.6	Apr	+ 3.2	May	+ 1.4	Apr	– 0.6	Q1	10.4	May
Venezuela	+29.8	Q1	+43.2	Mar	+21.8	May	+17.8	Q1	+12.3	Q1	17.8	Mar
Egypt	+ 3.1	2003†	+ 2.6	2003†	+ 5.5	Dec	– 6.0	Q4	+ 3.9	Q4	13.6	Feb
Israel	+ 2.6	Q1	– 0.5	Apr	– 0.6	May	– 5.9	May	+ 0.3	Q1	26.6	May
South Africa	+ 1.9	Q1	+ 2.9	Apr	+ 0.6	May	+ 1.1	May	– 2.0	Q1	8.9	May
Turkey	+10.1	Q1	+16.5	Apr	+ 8.9	May	–26.8	Apr	– 9.8	Apr	33.2	May
Czech Republic	+ 3.1	Q1	+10.1	Apr	+ 2.7	May	– 2.5	Apr	– 6.0	Q1	26.4	May
Hungary	+ 4.2	Q1	+ 9.4	Apr	+ 7.6	May	– 4.2	Apr	– 7.1	Apr	13.1	May
Poland	+ 6.9	Q1	+12.3	May	+ 3.4	May	– 6.0	Apr	– 3.1	Apr	35.3	May
Russia	+ 7.4	Q1	+ 5.5	May	+10.2	May	+65.7	Apr	+35.3	Q1	81.8	May
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 6.8	Q1	+ 7.9	May	+ 3.7	May	– 2.2	Apr	– 1.1	Q1	1.3	Apr
Latvia	+ 8.8	Q1	+ 9.4	Apr	+ 6.2	May	– 2.3	Apr	– 1.3	Apr	1.7	Apr
Lithuania	+ 7.7	Q1	na		+ 1.1	May	– 2.9	Apr	– 1.5	Q1	3.3	Apr
Slovakia	+ 5.5	Q1	+ 5.7	May	+ 8.3	May	– 0.4	Apr	nil	Mar	11.6	Apr
Slovenia	+ 3.7	Q1	– 0.9	Apr	+ 3.9	Jun	– 0.9	Apr‡	– 0.1	Apr	8.3	Mar
Pakistan	+ 5.1	2003†	+13.4	Feb	+ 7.1	May	– 2.7	May	+ 2.4	Q1†	11.1	May
Saudi Arabia	+ 6.4	2003	na		+ 0.3	Mar	+50.2	2003	+29.7	2003	22.1	Apr

*Excluding gold, except Singapore; IMF definition. †Year ending June.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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Financial markets

Jul 1st 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 30th		Dec 31st 2003	
	Jun 30th	year ago	Jun 30th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	15.0	2.80	1,468.8	-5.2	- 6.4	- 6.4
Hong Kong	7.80	7.80	14.1	0.46	12,285.8	+1.0	- 2.3	- 2.8
India	46.0	46.3	83.4	4.41	4,795.5	+0.1	- 17.9	- 18.5
Indonesia	9,403	8,220	17,052	7.56	732.4	+3.5	+ 5.9	- 5.2
Malaysia	3.80	3.80	6.89	2.87	819.9	+0.2	+ 3.3	+ 3.3
Philippines	56.2	53.3	101.8	7.81	1,579.4	+0.4	+ 9.5	+ 8.3
Singapore	1.72	1.75	3.12	0.75	1,838.0	+2.4	+ 4.2	+ 2.7
South Korea	1,156	1,187	2,096	3.93	785.8	+6.3	- 3.1	- 0.1
Taiwan	33.6	34.5	61.0	1.10	5,839.4	+1.9	- 0.9	nil
Thailand	40.9	41.9	74.1	1.33	646.6	+3.1	- 16.3	- 18.8
Argentina	2.96	2.80	5.37	5.38	945.5	-1.6	- 11.8	- 12.6
Brazil	3.10	2.83	5.62	15.81	21,148.0	+1.5	- 4.9	- 11.4
Chile	636	696	1,154	1.80	7,518.8	+1.1	+ 2.5	- 4.6
Colombia	2,693	2,812	4,883	7.81	3,004.5	+0.7	+ 28.7	+ 32.9
Mexico	11.5	10.5	20.9	6.80	10,281.8	+1.4	+ 16.9	+ 13.9
Peru	3.47	3.47	6.30	2.49	2,885.9	+1.3	+ 18.5	+ 18.2
Venezuela	2,601§	1,598	4,718	12.79	25,285.2	-1.3	+ 13.9	+ 24.8
Egypt	6.19	6.07	11.23	11.28	14,419.5	+3.4	+ 23.9	+ 23.4
Israel	4.50	4.30	8.16	1.00	596.2	+1.0	+ 11.6	+ 8.9
South Africa	6.22	7.40	11.3	8.20	10,108.6	+1.3	- 2.7	+ 4.5
Turkey	1,484,000	1,402,000	2,691,382	25.18	17,967.6	+6.8	- 3.5	- 8.7
Czech Republic	26.2	27.5	47.5	2.45	793.5	-1.4	+ 20.4	+ 18.1
Hungary	206	229	374	11.52	11,537.0	+1.7	+ 23.0	+ 23.8
Poland	3.70	3.85	6.70	6.05	23,949.3	+1.6	+ 15.0	+ 16.5
Russia	29.1	30.3	52.7	13.00	583.3‡	-3.3	+ 2.2	+ 2.8
EMF (MSCI)*	1.00	1.00	1.81	na	432.2	+2.8	- 2.4	- 2.4
EMBI+†	1.00	1.00	1.81	na	286.5	nil	- 2.8	- 2.8

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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